DEVELOPING SOUND BUSINESS PRACTICES AT THE DEPARTMENT OF HOMELAND SECURITY

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT EFFICIENCY
AND FINANCIAL MANAGEMENT

OF THE

COMMITTEE ON
GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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DEVELOPING SOUND BUSINESS PRACTICES AT THE DEPARTMENT OF HOMELAND SECURITY

WEDNESDAY, SEPTEMBER 10, 2003

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY AND FINANCIAL MANAGEMENT,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:40 p.m., in room 2203, Rayburn House Office Building, Hon. Todd R. Platts (chairman of the subcommittee) presiding.

Present: Representatives Platts, Towns, Owens, Turner and Blackburn.

Staff present: Mike Hettinger, staff director; Dan Daly, counsel; Larry Brady, Kara Galles, and Tabetha Mueller, professional staff members; Amy Laudeman, clerk; Mark Stephenson, minority professional staff member; and Jean Gosa, minority assistant clerk.

Mr. PLATTS. The Subcommittee on Government Efficiency and Financial Management will come to order.

We will begin with opening statements and an opening statement from the ranking member.

Two years ago tomorrow, America sustained the most devastating attack on the homeland in our history. We will always remember the tragic loss of life as a result of this attack. That day dealt a crushing blow to the confidence our citizens had in the Federal Government and its ability to protect them. The ability to protect the country from terrorism has become a national priority, and, to that end, Congress and the President established the Department of Homeland Security last year.

The creation of DHS is the largest reorganization of the Federal Government since the Department of Defense was established more than 50 years ago. It presents, arguably, the greatest management challenge in our Nation's history, bringing together 22 diverse entities under one umbrella, creating an entirely new organizational culture and structure. The establishment of this new Department does not add new responsibilities or increase the size of government; rather it reorganizes and reprioritizes functions, sharpening focus and increasing effectiveness. In that light, improving our Nation's security is essentially a test of the management and leadership abilities of the Federal, State and local governments.

DHS inherits agencies in varying financial condition with 19 different financial management systems and 15 compensation sys-

tems. Given the magnitude and importance of the Department's mission, sound business practices are critical to success and must be established at the outset. An important aspect of this realignment is to spend less on overhead and more on protecting America.

As part of this subcommittee's continuing oversight of Federal agency financial management, today we will examine the status of integrating component agencies into a single, effective department through the efficient consolidation of overlapping functions. Management consolidation and reform efforts at DHS deserve appropriate attention and oversight from Congress.

On July 24, 2003, I, along with full committee Chairman Tom Davis, Ranking Member Towns, full committee Ranking Member Waxman, and Vice Chairwoman Blackburn introduced H.R. 2886, the Department of Homeland Security Financial Accountability Act, which would apply the provisions of the Chief Financial Officers Act to DHS.

This hearing and the proposed legislation are essential steps toward ensuring that DHS establishes sound business practices from the outset, enabling the Federal Government to take advantage of efficiencies and use resources effectively to protect America. We have asked each of our witnesses to comment on the specific provisions of the legislation. It had been my expectation that we would mark this bill up today; however, we continue to work out the details with the Office of Management and Budget and the Department. Let me assure everyone in this room today that we will take up this legislation in the near future to ensure that financial accountability at DHS is prioritized and well achieved.

Let me also say that in working with OMB, the CFO and DHS, the IG, since the bill's introduction, we have all agreed to remove the section of the bill that would have waived the requirement for a complete financial audit in fiscal year 2003. We understand that the fiscal year 2003 audit is well underway and this run-up in 2003 is a necessary part of the process as we look to the 2004 financial statement audit process as well. Understanding that the waiver will be removed from the bill when it is marked up before the subcommittee, I would ask that each of our witnesses not dwell on the waiver issue in their oral statements and focus on the other parts of the proposal.

Today the subcommittee will hear from Ms. Linda Springer, Controller at the Office of Management and Budget; Mr. McCoy Williams, Director of Financial Management and Assurance at GAO; Dr. Bruce Carnes, Chief Financial Officer at the Department of Homeland Security; and Mr. Dick Berman, Assistant Inspector General for Audit in the Office of the Inspector General at DHS. Thank you for agreeing to testify today and for your written testimony you submitted prior to today's hearing and for the testimony you will offer here today.

[The prepared statement of Hon. Todd Russell Platts follows:]

ONE HUNDRED EIGHTH CONGRESS

Congress of the United States

House of Representatives

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Opening Statement
Todd Russell Platts
September 10th, 2003

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Mr. PLATTS. I will now yield to the gentleman from New York, Mr. Owens, if you would like to make an opening statement.

Mr. OWENS. No, thank you.

Mr. PLATTS. We will then proceed to our witnesses' testimony. If I could ask each of the witnesses and any who will be giving you advice or counsel as part of today's testimony to stand and raise your right hands and take the oath.

[Witnesses sworn.]

Mr. PLATTS. We will proceed directly to our testimonies. Ms. Springer, we will begin with you, followed by Mr. Williams, then Dr. Carnes and finally, Mr. Berman.

Again, the subcommittee appreciates the substantive nature of your written testimonies. If you could limit your oral testimony for the opening stage to approximately 5 minutes, we will then get into questions and answers.

Ms. Springer, would you like to proceed?

STATEMENT OF LINDA SPRINGER, CONTROLLER, OFFICE OF MANAGEMENT AND BUDGET

Ms. SPRINGER. Thank you, Mr. Chairman.

I want to apologize in advance for some laryngitis but hopefully the mic won't pick it up.

I appreciate the opportunity to appear before you again, this time to testify on financial management at the new Department of Homeland Security.

The creation of the department, as you said, marks one of the largest and most complex mergers ever undertaken by the Federal Government. There are many challenges involved with that creation of the department but the department has demonstrated a very strong commitment to financial excellence and should be recognized for its efforts during this past year.

Even before the creation of the Department at the beginning of March, individuals from the affected finance and budget offices of the 22 legacy agencies formed an interagency task force consisting of senior and mid-level management personnel. They met regularly to discuss issues and began developing solutions to the challenges that they started to see facing the new department.

The DHS has shown commitment to preparing audited financial statements in the first year of its existence demonstrating accountability both to the Congress and to the taxpayers. Even though they could have requested a waiver for this first year, they have decided to go forward not only with annual statements but also with their quarterly financial statements as well. We take that as a sign of the department's determination to be fiscally responsible right from its outset.

As with any merger, some of the new department's efforts will have to focus on some very immediate challenges. Many issues have been raised regarding the proper accounting treatment of the new Department's financial activity and the presentation of its financial statements that must be addressed. OMB has worked and continues to work with DHS to resolve these issues in a timely manner.

DHS must also begin to address longstanding weaknesses which it inherited from its component agencies such as weak financial ac-

counting and reporting processes, inadequate IT systems and ineffective real and personal property processes, to name a few. The department has inventoried these weaknesses and is developing corrective action plans, although the weaknesses still need to be resolved.

One of the areas you asked us to comment on was establishment of sound financial management and business processes. Clearly it is necessary for financial management to provide the Congress, the administration and the taxpayer with quality, timely information analysis related to its activities.

First in this area for focus, we believe, is ensuring top leadership. Leadership is critical to establishing a sound financial and management structure within the department. It is clearly true when you are trying to merge 22 disparate entities into a single entity with a clear vision of performance and expectations, it needs to be communicated throughout the organization. Leadership is absolutely critical to making that happen.

Additionally, it is important to have a financial management team with strength and the right mix of talent and skills that is dedicated to this transformation process under that strong leadership.

Second, we believe that a premiere financial organization has to recognize that it exists to provide that quality timely and relevant information about the financial implications of the program activities of the department, as well as the impact of those decisions and agency performance goals and objectives. To accomplish this, leading financial organizations need to recognize who their customers are and that they are serving both internal as well as external customers, allowing the mission and organization structure to support the entity's overall mission and objectives.

Third on the list would be seamless financial systems and business processes. It is important that a premiere financial organization builds seamless financial systems and business processes. At its earliest opportunity, DHS must determine the essential system and process infrastructure it requires throughout the organization. Its infrastructure must also be flexible enough to support information needs all the way down to a program level and certainly needs to have the robust financial functionality within that architecture that recognizes hallmarks within strong financial institutions.

Fourth, we believe that in seeking to create a premiere financial organization, DHS must pursue means that will permit it to routinely generate reliable cost and performance information. These analytics combined with other value added activities will support the agency's missions and goals and as DHS moves forward in developing next generations of strategic plans, we believe the financial organization will accordingly design its reporting formats and its performance measurements to align well with measuring execution of that strategy.

With respect to the bill the committee has produced, H.R. 2886, OMB as well has high expectations of solid financial management practices for the department, so we are very closely in partnership and alignment with the committee's interests. We appreciate those efforts in the bill and look forward to continue to work with you as the legislation is fine-tuned.

We are obviously glad to hear that the provision related to the fiscal year 2003 waiver has been adjusted and we think that is appropriate. We applaud the department for its good work in completing the 2003 financial statement process. We think that speaks well to their dedication to financial integrity.

With respect to the internal control audit opinion, the bill obviously also contains a requirement for DHS to include in each performance and accountability report an audit opinion of internal controls over financial reporting. It is our understanding that this requirement is intended to hold Federal agencies to a similar standard found in the private sector or I should say anticipated in the private sector which Sarbanes actually becomes effective, which as of yet it has not. In fact, Sarbanes-Oxley has been delayed to give further study about certain concerns that we think also would apply to Federal agencies. These are things related to cost and time to implement related to the robustness of auditing standards by the auditor and an understanding of the scope that is needed.

Again, we believe those same considerations apply and to that end we believe the CFO council and the audit community, the President's Council on Integrity and Efficiency, should work together in a task force to identify and do an appropriate cost benefit study on the internal control audit requirement and make a recommendation on how that should be implemented.

With respect to the application of the CFO Act to the new department, it is OMB's position that the substantive provisions of the CFO Act should apply and that they do apply to the new department as they do to every other major department or agency of the Federal Government.

The CFO Act does specify a certain organization structure which is different than that consistent with the Homeland Security Act of 2002. We believe that the consolidation of management responsibilities under an Under Secretary in the department does provide for a strong management structure and believe that is consistent with the effort by the administration working with Congress to reduce the number of officials subject to confirmation by the Senate. We have had some discussions and continue to discuss that with you.

Just to conclude, we believe that establishing sound financial management and business processes at the department is something that is being taken very seriously by the financial staff and that the right steps are being taken. We applaud the department, they have demonstrated that commitment and we look forward to continuing at OMB to work with the department as they go forward.

I look forward to answering your questions.

Thank you.

[The prepared statement of Ms. Springer follows:]

Statement of
The Honorable Linda M. Springer
Controller, Office of Federal Financial Management,
Office of Management and Budget,
Before the
Subcommittee on Government Efficiency and Financial Management
Committee on Government Reform
United States House of Representatives
September 10, 2003

Thank you, Mr. Chairman, for the opportunity to appear before you today to testify on financial management at the Department of Homeland Security (DHS). As you know, the enactment of the Homeland Security Act of 2002 (P.L. 107-296) represents an historic moment of almost unprecedented action by the Federal Government to fundamentally transform how the nation will protect itself from terrorism. Rarely in our country's past has such a large and complex reorganization of government entities occurred with such a singular and urgent purpose.

The government is undertaking a unique effort to transform a distinct group of agencies with multiple missions, values, and cultures into a strong and effective cabinet department whose mission is to analyze threats and intelligence, guard U.S. borders and airports, protect the nation's critical infrastructure, and coordinate the country's response for future emergencies. This unique opportunity, however, comes with many challenges, including those related to the new department's stewardship obligation to use tax dollars appropriately and to ensure accountability to the President, the Congress, and the American people.

The Homeland Security Department's charge to have a premier financial management organization is no different than the objective this Administration and the Congress have set before each of the departments and agencies in the executive branch. However, the merger of 22 disparate entities, each with different missions, cultures, programs and operating systems, greatly complicates the task and places the Department at higher risk for ineffective and inefficient financial management.

But with great challenge comes great opportunity—both the opportunity to reengineer and develop seamless systems and processes that support day-to-day operations and the opportunity to provide analysis and insight about the financial implications of program decisions that will ultimately assist this Administration, the Congress, and other decision-makers in evaluating the value and cost of federal programs.

Overview of DHS Financial Management Challenges

The creation of the Department of Homeland Security marks one of the largest and most complex mergers ever undertaken by the Federal Government. Yet, in the face of the

many challenges involved with its creation, DHS has demonstrated a strong commitment to financial excellence and should be recognized for its efforts during the past year.

Even before the creation of the Department of Homeland Security on March 1, 2003, individuals from the affected finance and budget offices formed an interagency task force, consisting of senior and mid-level management, which met regularly to identify issues and begin developing solutions to many of the challenges facing the new Department. To ensure a smooth transition, this task force worked with OMB and others to: identify key financial, logistical, and human resources that would be transferred to the new Department; develop interim management directives that would provide at least temporary direction to the new Department; analyze the affects of moving the smaller components into the larger components; study the capabilities of the financial management systems in place at its largest components; and identify the audit scope of the new Department and its legacy agencies.

DHS has worked with the Financial Accounting Standards Advisory Board (FASAB) to develop guidance on a financial statement presentation that is consistent with current accounting standards. The Department has also consulted OMB to ensure that performance reporting for fiscal year 2003 is meaningful to the reader of the performance and accountability report. Further, OMB has worked with the Department on a myriad of technical financial issues, such as the appropriate presentation of Customs revenue, which has been delegated to DHS but whose collection remains a responsibility of the Department of the Treasury.

DHS has shown commitment to preparing audited financial statements in its first year of existence to demonstrate accountability to the Congress and the American people, even though the Accountability of Tax Dollars Act of 2002 allows the Department to request a waiver from this requirement. This commitment, coupled with the preparation of quarterly financial statements, shows the Department's determination to be fiscally responsible from its inception, accounting for all transferred assets, liabilities, and operations. DHS' goal is to obtain an unqualified (clean) opinion for fiscal year 2003 and, if events permit, to issue its performance and accountability report on an accelerated timeframe.

As with any merger, some of the new Department's efforts must focus on the most immediate challenges. Other efforts, however, by their nature will take several years to successfully develop and implement. The startup of DHS, unlike other agencies that carry out programs through grants or other third parties, is largely a salaries and expense agency with its own personnel and assets carrying out its vast responsibilities. Cost control and asset management, coupled with the need to successfully blend individuals from departments and agencies with different cultures, values, and missions, are critical to its effectiveness and efficiency. Although the creation of DHS began just over six months ago, it is off to a good start with regard to its financial management.

One of the first challenges DHS must overcome is to obtain a clean audit opinion on its financial statements, which will demonstrate tangible evidence of its efforts to create a

premier financial management organization. Reaching that goal, however, will require a cooperative effort among the 22 entities that were transferred to the Department mid-year.

Many issues have been raised regarding the proper accounting treatment of the new Department's financial activity and its presentation in the financial statements that must be addressed. OMB has worked, and continues to work, with DHS to resolve these issues in a timely manner. Undoubtedly, new issues will surface, but we look forward to working with DHS to address them together.

DHS must also begin to address the longstanding weaknesses inherited from its components, such as weak financial accounting and reporting processes, inadequate information technology (IT) systems functionality and security controls, ineffective real and personal property processes, and insufficient internal controls over duties and taxes. The Department has inventoried these weaknesses and developed corrective action plans, although these weaknesses are not yet resolved.

DHS has already taken steps to integrate the diverse financial and performance information systems. It has identified the financial management systems to which the smaller component agencies may migrate beginning October 1. However, this step is just the first of many in a long process to streamline the Department's systems. The Chief Financial Officer (CFO) must also identify the Department's IT assets and then, in conjunction with each program, determine what IT assets are needed to meet mission requirements. The CFO must work with the Chief Information Officer (CIO) to identify a financial management system or systems to meet user needs, whether it be commercial-off-the-shelf, internally developed, or a hybrid of the two.

Establishing Sound Financial Management and Business Processes

The push to create a citizen-centered, results-oriented government has been exacerbated by the demands on available resources. It is necessary for financial managers to provide its management, this Administration, the Congress and other decision-makers with quality, timely information and analysis that better informs about the financial implications of program decisions and the impact of those decisions on agency performance goals and objectives. To this end, we believe that DHS must focus its attention on four critical areas:

- Ensuring top leadership drives the transformation to a single agency, single vision/goal
- Creating the financial organization that adds value and supports the Department's mission
- Establishing seamless financial systems and businesses processes
- Providing meaningful information to decision-makers by routinely generating reliable cost and performance information analysis

Ensuring Top Leadership. Leadership is critical to establishing sound financial management within the Department. The merger of 22 disparate entities into a single financial organization must begin with a clear vision of performance and expectations that

is communicated throughout the organization at all levels. To be successful, DHS' top leadership must make attaining that vision a priority, and the message must be reinforced in both words and actions.

A vision of fundamentally improved financial management and the uncompromising organization-wide pursuit of that vision are critical within the culture of DHS. A foundation of control and accountability that supports external reporting and performance management, as well as using training to change the organizational culture and engage program managers, serves to provide necessary clear and strong executive leadership. Additionally, it is also important to have a financial management team, with the right mix of skills and competencies that is dedicated to the transformation process to ensure changes are thoroughly implemented and sustained over time.

Creating the Financial Organization. A premier financial organization must recognize that it exists to provide quality, timely and relevant information about the financial implications of program decisions and the impact of those decisions on agency performance goals and objectives. To accomplish this purpose, leading financial organizations must serve their customers both internally and externally, aligning their mission and organizational structure to better support the entity's mission and objectives. DHS should take all necessary steps toward creating a financial team that supports the overall missions, goals, and objectives of the Department.

Seamless Financial Systems and Business Processes. Building a premier financial organization will also require DHS to establish seamless financial systems and business processes to enable it to successfully fulfill its mission and achieve its goals and objectives. At the earliest opportunity, DHS must determine the essential system and process infrastructure that it requires throughout the organization. This infrastructure must also be flexible enough to support information needs at the detailed program level.

To this end, it is crucial that DHS give careful thought to its IT modernization efforts. OMB's experience with federal agencies has shown that attempts to modernize IT environments require specific blueprints, models that simplify the complexities of how agencies operate today, how they want to operate in the future, and how they will get there. In the absence of such blueprints, there is often unconstrained investment and systems that are duplicative and ineffective. Certain enterprise architectures offer such blueprints. If managed properly, architectures can clarify and help optimize the interdependencies and interrelationships among enterprise operations and the underlying IT infrastructure and applications that support them. The development, implementation, and maintenance of such an architecture, inclusive of robust financial functionality, are recognized hallmarks of successful public and private organizations.

Providing Meaningful Information. In seeking to create a premier financial organization, DHS must also pursue means that will permit it to routinely generate reliable cost and performance information analysis. Such analytics combined with other value-added activities will support the agency's mission and goals. This capability is a requirement for

"getting to green" on the *Improved Financial Performance* initiative of the President's Management Agenda, and it gets to the heart of first-class financial management.

The creation of DHS provides an opportunity to reengineer much of the management reporting formats produced by its components to meet the needs of its users. As DHS looks to develop a new strategic plan that will outline its goals and objectives, its financial organization should design reporting formats that are aligned to measure performance in executing its strategy.

H.R. 2886, "Department of Homeland Security Financial Accountability Act"

Similar to the Committee, OMB has high expectations of solid financial management practices for this new Department, especially in light of its unique role and function within the Federal Government. To that end, we appreciate your efforts in introducing H.R. 2886, the "Department of Homeland Security Financial Accountability Act," and we look forward to discussing several issues of this legislation with you.

Fiscal Year 2003 Financial Reporting and Audit. Preparation of audited financial statements is a crucial step in DHS's path to financial management excellence. The Department of Homeland Security Financial Accountability Act (H.R. 2886), however, contains a provision that would lift the requirement of DHS to prepare and submit audited financial statements for any fiscal year before fiscal year 2004. It is our understanding that this provision is intended to provide DHS with adequate time to meet this requirement. (A similar provision is not included in the Senate companion bill, S. 1567.)

Much work has already been done toward the completion of the fiscal year 2003 financial statement process at DHS. As the Department's acting Inspector General recently communicated to the Committee on Government Reform, the fiscal year 2003 audit is very much in progress. This effort has not only involved the Department and its auditors but also the 22 legacy agencies, the Financial Accounting Standards Advisory Board, and others. It is our understanding from discussions with the Office of the Chief Financial Officer that DHS intends to see this process to its conclusion.

OMB commends DHS for its recognition of the value that is provided in this initial year by preparing and undergoing an audit of financial statements, and it is the position of OMB that this process be completed to gain full benefit. We would ask the Committee to allow the Department to continue the fiscal year 2003 financial reporting and audit process.

Internal Control Audit Opinion. H.R. 2886 also contains a requirement for DHS to "include in each performance and accountability report an audit opinion of the Department's internal controls over its financial reporting." It is our understanding that this requirement is intended to hold Federal agencies to the same standards for financial accountability as the private sector. At the present time, however, no other sectors are required to obtain an audit opinion on internal control.

While SEC registrants will be subjected in the future to such a requirement under Section 404 of the Sarbanes-Oxley Act (enacted July 2002), the effective date has been delayed as a result of public comments. The provision was originally planned for fiscal years ending on or after September 15, 2003, but was deferred to fiscal years ending on or after June 15, 2004, for large US companies, and April 15, 2005, for smaller US companies and foreign companies. This deferral recognized the following concerns (as outlined in a May 29, 2003, speech by SEC Deputy Chief Accountant Scott A. Taub):

- cost and time needed to properly implement the rules;
- uncertainty and disagreements about the level of work required to comply with the internal control requirement;
- whether sufficient time was permitted to resolve uncertainties adequately; and
- whether the professional auditing standards needed revision.

These same concerns would also apply to federal agencies.

The Administration acknowledges that obtaining an audit opinion on internal control is a potentially useful, yet very significant, undertaking. While we agree that an opinion level internal control audit could have merit, a review of this magnitude will require the allocation of additional resources and sufficient time to coordinate among agency Chief Financial Officers, Inspectors General, and independent public auditors.

Three agencies (General Services Administration, Nuclear Regulatory Commission, and Social Security Administration) have voluntarily elected to obtain audit opinions on internal control; however, cabinet departments and other agencies covered by the Chief Financial Officers Act (CFO Act) are not currently required to obtain such an opinion. This provision, if enacted, would impose a more stringent requirement on DHS than other Federal departments and agencies. OMB recommends that a cost-benefit study of the internal control audit provision be performed jointly by the CFO Council and the President's Council on Integrity and Efficiency to provide the necessary insight as to the cost and proper timing of such a requirement.

Applying the CFO Act to DHS. It is OMB's position that the substantive provisions of the CFO Act should apply to the new Department of Homeland Security as they do every other major Department and agency of the Federal Government. However, the CFO Act specifies an organizational structure – direct reporting of the CFO to the agency head – that is inconsistent with the structure Congress endorsed when it passed the Homeland Security Act of 2002. The Homeland Security Act enacted the President's proposal to consolidate management responsibilities at the new Department under the Under Secretary for Management. The Administration believes that with a strong and competent leader in the position of Under Secretary for Management, sound management policies and practices receive maximum standing within the agency. Requiring the CFO at the Department of Homeland Security to report directly to the Secretary of Homeland Security would dilute this principle.

The Administration is also working with Congress to reduce the number of officials subject to confirmation by the Senate, and therefore opposes making the CFO subject to confirmation by the Senate. In this vein, Congress agreed last fall that through passage of the Homeland Security Act, the Department of Homeland Security CFO would not be subject to Senate confirmation. This action does not compromise the applicability of the qualification requirement for CFOs as articulated by the Act.

I hope we can work together to apply the substantive provisions of the CFO Act to the new Department of Homeland Security, while remaining faithful to the President's original proposal to create the new Department, as well as the Homeland Security Act of 2002.

Conclusion

Establishing sound financial management and business processes within the Department of Homeland Security will not occur overnight. Rather, such a transformation will take several years to achieve. OMB believes that DHS has demonstrated a commitment to sound financial management, and its focus on implementing the most effective and efficient systems and processes is the beginning to achieve this outcome.

Thank you, Mr. Chairman. I look forward to answering your questions.

Mr. PLATTS. Thank you, Ms. Springer.

Mr. Williams, before you begin, I just want to correct my earlier statement. I think I said Acting Inspector General for Audit instead of Assistant Inspector General for Audit. I stand corrected and apologize for that mistake.

Mr. Williams.

STATEMENT OF MCCOY WILLIAMS, DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE TEAM, U.S. GENERAL ACCOUNTING OFFICE

Mr. WILLIAMS. Mr. Chairman and members of the subcommittee, I am pleased to be here today to discuss the financial management challenges facing the Department of Homeland Security, the steps the department must take to establish sound financial management and business processes and to give GAO's comments on H.R. 2886, the Department of Homeland Security Financial Accountability Act.

The Homeland Security Act of 2002 brought together 22 agencies to create a new Cabinet level department to focus on reducing our vulnerability to terrorist attacks and to minimize damages and assist in recovery if an attack does occur. Achieving this mission will require a results-oriented environment with a strong financial management infrastructure.

Creating strong financial management in DHS is particularly challenging because most of the entities brought together to form the department bring their own financial management systems, processes and in some cases, deficiencies. Four of the seven major agencies that transferred to DHS reported 18 material weaknesses in internal control in fiscal year 2002. All but two of the seven major agencies had financial management systems that were not in substantial compliance with the Federal Financial Management Improvement Act of 1996. DHS will need to address these and other financial management issues, some of which may not yet be known.

DHS can take some immediate steps to begin addressing these financial management issues. In April 2000, GAO reported on a study of nine leading private and public sector finance organizations in Creating Value Through World Class Financial Management. This executive guide includes four steps we believe DHS can take to begin developing sound financial management and business processes. They include making financial management an entity-wide priority; redefining the role of finance; providing meaningful information to decisionmakers; and building a team that delivers results.

It is well recognized that mergers of the magnitude of DHS carry significant risks, including lost productivity. Necessary management capacity, communication and information systems, and sound financial management and business processes must be established if DHS is to achieve a successful transformation.

H.R. 2886 can help facilitate the creation of a first rate financial management architecture at DHS by providing the necessary tools and setting high expectations. The bill would make DHS a CFO Act agency, require DHS to obtain an opinion on internal controls

and require DHS to include program performance information in its performance and accountability reports.

GAO fully supports the objectives of the CFO Act to provide reliable financial information and improve financial management systems and control, and believes DHS should be included under the CFO Act. Further, GAO strongly believes that auditor reporting on internal controls can be a critical component of monitoring the effectiveness and accountability of an organization and support DHS, as well as, other CFO Act agencies in obtaining such opinions. In addition, GAO supports including program performance information in agency performance and accountability reports. We strongly encourage DHS to report this information in its accountability report.

Finally, DHS has stated its commitment to obtaining a financial audit for fiscal year 2003. We support this position.

Mr. Chairman, this completes my prepared statement. I would be happy to respond to any questions.

[The prepared statement of Mr. Williams follows:]

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives

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DEPARTMENT OF HOMELAND SECURITY

Challenges and Steps in Establishing Sound Financial Management

Statement of McCoy Williams, Director
Financial Management and Assurance

GAO
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GAO-03-1134T

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Highlights

Highlights of GAO-03-1134T, a testimony before the Subcommittee on Government Efficiency and Financial Management, House Committee on Government Reform, House of Representatives

Why GAO Did This Study

Based on its budget, the Department of Homeland Security (DHS) is the largest entity in the federal government that is not subject to the Chief Financial Officers (CFO) Act of 1990. The department, with an estimated $39 billion in assets, an almost $40 billion fiscal year 2004 budget request, and more than 170,000 employees, does not have a presidentially appointed CFO subject to Senate confirmation and is not required to comply with the Federal Financial Management Improvement Act (FFMIA) of 1996. In addition, we designated implementation and transformation of DHS as high risk based on three factors: (1) the implementation and transformation of DHS is an enormous undertaking that will take time to achieve in an effective and efficient manner, (2) components to be merged into DHS already face a wide array of existing challenges, and (3) failure to effectively carry out its mission would expose the nation to potentially very serious consequences.

In light of these conditions, the Subcommittee asked GAO to testify on the financial management challenges facing DHS, steps for establishing sound financial management and business processes at DHS, and GAO's comments on H.R. 2886, The Department of Homeland Security Financial Accountability Act.

www.gao.gov/cgi-bin/getrpt?GAO-03-1134T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact McCoy Williams at 202-512-6906 or williamsm1@gao.gov.

September 10, 2003

FINANCIAL MANAGEMENT

Department of Homeland Security: Challenges and Steps in Establishing Sound Financial Management

What GAO Found

The Homeland Security Act of 2002 brought together 22 agencies to create a new cabinet-level department focusing on reducing U.S. vulnerability to terrorist attacks, and minimizing damages and assisting in recovery from attacks that do occur. Meeting this mission will require a results-oriented environment with a strong financial management infrastructure.

Creating strong financial management at DHS is particularly challenging because most of the entities brought together to form the department have their own financial management systems, processes, and in some cases, deficiencies. Four of the seven major agencies that transferred to DHS reported 18 material weaknesses in internal control for fiscal year 2002 and five of the seven major agencies had financial management systems that were not in substantial compliance with FFMIA. For DHS to develop a strong financial management infrastructure, it will need to address these and many other financial management issues.

Through the study of several leading private and public sector finance organizations (*Creating Value Through World-class Financial Management*, GAO/AIMD-00-134), GAO has identified success factors, practices, and outcomes associated with world-class financial management. Four steps DHS can take to begin developing sound financial management and business processes are to: (1) make financial management an entitywide priority, (2) redefine the role of the finance organization, (3) provide meaningful information to decision makers; and (4) build a team that delivers results.

H.R. 2886 can help facilitate the creation of a first-rate financial management architecture at DHS by providing the necessary tools and setting high expectations. The bill would (1) make DHS a CFO Act agency, (2) require DHS to obtain an opinion on its internal controls, and (3) require DHS to include program performance information in its performance and accountability reports. GAO fully supports the objectives of the CFO Act to provide reliable financial information and improve financial management systems and controls and believes DHS should be included under the act and therefore also subject to FFMIA. Further, GAO strongly believes that auditor reporting on internal control can be a critical component of monitoring the effectiveness and accountability of an organization and supports DHS, as well as other CFO Act agencies, obtaining such opinions. In addition, GAO supports agencies including program performance information in their performance and accountability reports and strongly encourages DHS to report this information voluntarily. Finally, as introduced, H.R. 2886 provided a waiver allowing DHS to forego a financial statement audit for fiscal year 2003. We understand an agreement has been reached to remove this waiver from the proposed legislation. DHS has committed to a 2003 financial statement audit, which is already underway. GAO supports dropping this provision from H.R. 2886.

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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the major financial management challenges facing the Department of Homeland Security (DHS), steps for establishing sound financial management and business processes, and our comments on H.R. 2886, The Department of Homeland Security Financial Accountability Act. The perspective we offer in this testimony is derived from an extensive body of work on these topics completed by inspector generals, independent auditors, as well as from GAO reports; executive guidance; and testimony related to financial management and DHS.

The Homeland Security Act of 2002 brought together 22 diverse agencies and created a new cabinet-level department to help prevent terrorist attacks in the United States, reduce the vulnerability of the United States to terrorist attacks, and minimize the damage and assist in recovery from attacks that do occur. Efforts to improve homeland security will require a results-oriented approach to ensure mission accountability and sustainability over time, and DHS must have a strong financial management infrastructure to support these goals. As stated in the President's Management Agenda, accurate and timely financial information is needed to secure the best performance and highest measure of accountability for the American people.

DHS has stated its commitment to becoming a model of efficiency and effectiveness for the federal government. To achieve this goal, it must first overcome significant challenges in integrating 22 separate agencies and their systems into a single, effective department, as well as correct the wide array of existing management challenges in the inherited components. Developing a financial management architecture with integrated systems and business processes is one of the many difficult challenges the new department faces. We designated implementation and transformation of DHS as high risk based on three factors: (1) the implementation and transformation of DHS is an enormous undertaking that will take time to achieve in an effective and efficient manner, (2) components to be merged into DHS already face a wide array of existing challenges, and (3) failure to effectively carry out its mission would expose the nation to potentially very serious consequences.[1] Our high-risk program has helped the executive branch and the Congress to galvanize efforts to seek lasting solutions to high-risk problems and challenges.

[1] *High-Risk Series: An Update*, GAO-03-119 (Washington, D.C.: January 2003).

Complicating DHS's efforts to develop a strong financial management infrastructure are the many known financial management weaknesses and vulnerabilities in the agencies DHS inherited. For example, for four of the seven major agencies[2] that transferred to DHS on March 1, 2003—the Immigration and Naturalization Service (INS), the Transportation Security Administration (TSA), the Customs Service, and the Federal Emergency Management Agency (FEMA)—auditors reported 18 material weaknesses[3] in internal control for fiscal year 2002. Further, for five of the seven major agencies, auditors reported that the agencies' financial management systems were not in substantial compliance with the Federal Financial Management Improvement Act (FFMIA) of 1996.[4]

Building an effective financial management infrastructure will require sustained leadership from top management. Currently, based on its budget, DHS is the largest entity in the federal government that is not subject to the Chief Financial Officers (CFO) Act of 1990.[5] As such, this department, with a fiscal year 2004 budget request of nearly $40 billion and currently more than 170,000 employees, does not have a presidentially appointed CFO subject to Senate confirmation and is not required to comply with FFMIA. The goals of the CFO Act and related financial reform legislation, such as FFMIA, are to provide the Congress and agency management with reliable financial information for managing and making day-to-day decisions and to improve financial management systems and controls to properly safeguard the government's assets. DHS should not be the only cabinet-level department not covered by what is the cornerstone for pursuing and achieving the requisite financial management systems and capabilities in the federal government.

[2]The seven major agencies that were transferred to DHS are: Immigration and Naturalization Service, Federal Emergency Management Agency, Customs Service, Transportation Security Administration, the Office of Domestic Preparedness, the U.S. Coast Guard, and the Secret Service.

[3]A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or noncompliance, which are material in relation to the financial statements or to stewardship information, would be prevented or detected on a timely basis.

[4]FFMIA requires auditors, as part of CFO Act agencies' financial statements, to report whether agencies' financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the federal government's standard general ledger at the transaction level.

[5]Pub. L. No. 101-576, 104 Stat. 2838 (1990).

The creation of DHS presents an opportunity for the federal government to ensure that it designs and implements a world-class organization with a first-rate financial management systems architecture. Providing DHS with the necessary tools, which would be facilitated by the passage of H.R. 2886, and setting high expectations are of paramount importance to its success. First, however, DHS must overcome many financial management challenges, which I will now discuss.

DHS Faces Significant Financial Management Challenges

Although many of the larger agencies that transferred to DHS have been able to obtain unqualified or "clean" audit opinions on their annual financial statements, most employed significant effort and manual work-arounds to do so in order to overcome a history of poor financial management systems and significant internal control weaknesses. Furthermore, some of the entities that transferred may also have weaknesses not yet identified or reported on merely because the problems were considered small or immaterial in relation to their large parent departments, such as the Department of Defense or the U.S. Department of Agriculture. Such weaknesses may become evident now that these smaller agencies are proportionately larger as a part of DHS, add to the known extensive existing challenges, and may therefore be subjected to increased levels of audit scrutiny. Cumulatively, these weaknesses and the efforts needed to resolve them to achieve sound financial management and business processes are an important reason for amending the CFO Act to include DHS and measuring DHS's financial management systems and internal control against the same important financial reform legislation and performance expectations as other federal departments and agencies.

DHS, like other federal agencies, has a stewardship obligation to prevent fraud, waste, and abuse, to use tax dollars appropriately, and to ensure financial accountability to the President, the Congress, and the American people. For the most part, DHS's component entities are using legacy financial management systems that have a myriad of problems, such as disparate, nonintegrated, outdated, and inefficient systems and processes. DHS will need to focus on building future systems as part of its enterprise architecture approach to ensure an overarching framework for the agency's integrated financial management processes. Plans and standard accounting policies and procedures must be developed and implemented to bridge the many financial environments in which inherited agencies currently operate to an integrated DHS system.

Another significant challenge for DHS is fixing the previously identified weaknesses that the agencies bring with them to DHS, a number of which I will now discuss.

Immigration and Naturalization Service

While receiving unqualified audit opinions on its fiscal year 2001 and 2002 financial statements,[6] the former INS under the Department of Justice (DOJ) faces numerous challenges in achieving a sound financial management environment. Although INS was abolished and split into multiple bureaus within DHS, its prior financial management weaknesses will still need to be addressed and could be further complicated by this realignment.

For fiscal year 2002, INS's financial statement auditors reported three material internal control weaknesses and that its systems were not in substantial compliance with FFMIA. Specifically, auditors noted limitations in the design and operation of INS's financial accounting system, thereby requiring it to use stand-alone systems or obtain the required financial information via manual processes and nonroutine adjustments as part of the financial statement preparation process. Having systems that can routinely produce information for financial reporting on demand for day-to-day decision making is one of the expected results of the President's Management Agenda, as well as one of the goals of FFMIA.

In addition, for both fiscal years 2001 and 2002, auditors reported that INS did not have a reliable system for providing regular, timely data on the numbers of completed and pending immigration applications, and the associated collections of fees valued at nearly $1 billion for fiscal year 2002. Accordingly, INS was not able to accurately and regularly determine fees it earns without relying on an extensive servicewide, year-end physical count of over 5.4 million pending applications, as was the case in fiscal year 2002. INS has been developing a new tracking system to facilitate its inventory process. However, until the new system is implemented, INS must rely on inefficient manual processes that significantly disrupt its operations. These and other inherent weaknesses in INS's financial management process limit its ability to produce useful, accurate, and timely financial information.

[6] U.S. Department of Justice, Office of Inspector General, *Immigration and Naturalization Service Financial Statements, Fiscal Year 2002*, Audit Report No. 03-22 (Washington, D.C. May 2003).

Despite the importance and prevalence of information technology (IT) systems in accomplishing its core missions, INS has not yet established and implemented effective controls for managing its IT resources.[7] The root cause of INS's systems problems has been an absence of effective enterprise architecture management and an IT investment management process. To address such weaknesses, INS has been developing an enterprise architecture, including a current and target architecture, as well as a transition plan. Similarly, INS has taken steps to implement rigorous and disciplined investment management controls. However, with the transfer to DHS and the splitting of INS, these plans will have to be reanalyzed, further delaying implementation of effective systems and complicating DHS's ability to produce reliable, timely, and accurate financial statements and information.

Federal Emergency Management Agency

FEMA, the only CFO Act agency to transfer in its entirety to DHS, faces several major financial management challenges, in spite of receiving an unqualified opinion on its fiscal year 2002 financial statements.[8] In fiscal year 2002 FEMA's auditors reported six material internal control weaknesses and that FEMA's financial management systems were not in substantial compliance with the requirements of FFMIA. One major weakness was FEMA's inability to efficiently prepare accurate financial statements as called for in the President's Management Agenda. For example, auditors reported that for fiscal year 2002, FEMA did not have an integrated financial reporting process that could generate financial statements as a byproduct of already existing processes, and that its financial statements were prepared late and required significant revisions.

In addition, auditors reported in fiscal year 2001 and again in fiscal year 2002 that FEMA did not have adequate accounting systems and processes to ensure that all property, plant, and equipment were properly recorded, accurately depreciated, and tracked in accordance with its polices and applicable federal accounting standards. As a result, FEMA's property management system cannot track items to supporting documentation or to a current location. Furthermore, FEMA lacks procedures to ensure that

[7]U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Justice*, GAO-03-105 (Washington, D.C.: January 2003).

[8]Federal Emergency Management Agency, *Annual Performance and Accountability Report Fiscal Year 2002* (Washington, D.C.: Jan. 24, 2003).

(1) equipment is consistently recorded on either a system or a component basis, (2) procedures are in place to ensure that property inventories are performed properly, and (3) all equipment is entered into its personal property management system. As a result, there is an increased risk that equipment and other property could be lost, stolen, or improperly recorded in its accounting records.

Since FEMA was the only agency to transfer to DHS in its entirety, it, unlike all of the other agencies, is left without a legacy department to prepare financial statements for the first 5 months of activity for fiscal year 2003 or an Office of Inspector General (OIG) to audit them, leaving FEMA's financial management information for the first 5 months of this fiscal year vulnerable to omissions, errors, and ultimately material misstatements. Given the weaknesses in, among other things, FEMA's property controls, we are initiating a review of FEMA's disbursement activity and property management controls covering this 5-month period. We will keep this Subcommittee informed of our progress in this review. Until corrective actions are implemented to address weaknesses, FEMA will not be able to achieve effective financial accountability or ensure that property is properly accounted for.

U.S. Customs Service

In fiscal year 2002, Customs under Treasury received a qualified opinion on a limited scope review[9] of its internal controls. This qualified opinion was due to the identification of four material weaknesses in Customs' internal controls by its independent auditors.[10] For example, auditors reported that Customs' financial systems did not capture all transactions as they occurred during the year; did not record all transactions properly; were not fully integrated; and did not always provide for essential controls with respect to override capabilities. As a result, extensive manual procedures and analysis were required to process certain routine transactions and prepare year-end financial statements.

[9]A limited scope review was performed in lieu of a financial statement audit due to security clearance procedures and other matters related to the access and handling of sensitive information, which delayed the start of the IT evaluation and thus prevented the auditors from completing test work on IT general and application controls.

[10]U.S. Department of the Treasury, Office of Inspector General, *Financial Management: Report on Internal Control Over Financial Reporting of the U.S. Customs Service for Fiscal Year 2002*, OIG-03-033 (Washington, D.C.: Dec. 16, 2002).

Customs, which typically collects and processes over $23 billion in fees annually, was found to have poor collection procedures throughout the agency. Ongoing weaknesses in the design and operation of Customs' controls over trade activities and financial management and information systems continue to inhibit the effective management of these activities and protection of trade revenue. For example, auditors reported that Customs' Automated Commercial System could not provide summary information on the total unpaid assessments for duties, taxes, and fees by individual importer. The system also could not generate periodic management information on outstanding receivables, the age of receivables, or other data necessary for managers to effectively monitor collection procedures. Such a capability would allow Customs to give managers timely access to program revenue information and more effectively present performance measures, which is critical for implementation of the President's Management Agenda.

Despite Customs' progress in implementing recommendations GAO and others have made over the years, numerous weaknesses continue to hinder progress toward developing Customs' planned import system, the Automated Commercial Environment (ACE).[11] ACE is intended to replace the current system used for collecting import-related data and ensuring, among other things, that trade-related revenue is properly collected and allocated. To ensure proper implementation of these initiatives, DHS's management must continue to provide a sustained level of commitment to its successful implementation. Until this system is fully implemented, billions in trade-related revenue will continue to be tracked by systems with inadequate controls. In addition, like INS, Customs faces additional financial management challenges because it was split into various components.

Transportation Security Administration

TSA was created by the Aviation and Transportation Security Act[12] under the Department of Transportation (DOT) in November 2001, to develop transportation security policies and programs that contribute to providing secure transportation for the American public. Despite its short history, the

[11] U.S. General Accounting Office, *Customs Service Modernization: Automated Commercial Environment Progressing, but Further Acquisition Management Improvements Needed*, GAO-03-406 (Washington, D.C.: February 2003).

[12] Pub. L. No. 107-71, 115 Stat. 597 (2001).

former TSA brings to DHS numerous financial management issues. In fiscal year 2002, auditors reported five material weaknesses and that TSA's systems were not in substantial compliance with FFMIA.[13] Specifically, auditors found that TSA management had not established written accounting policies and procedures to properly perform TSA's financial management and budgeting functions during fiscal year 2002. This is an example of what can happen when a newly created entity does not thoroughly develop and implement standard accounting policies and procedures. DHS should carefully review TSA's weaknesses to avoid experiencing them on a departmentwide basis.

Auditors also reported that TSA did not maintain complete and accurate records of its passenger and baggage screening equipment, most notably its Explosive Detection System (EDS) equipment. For example, a significant amount of fixed assets were found to not be recorded in the financial statements and an adjustment of approximately $149 million was made after year-end to properly record construction in progress for the manufacture of EDS equipment. Until such weaknesses are resolved, millions of dollars spent on new equipment and other fixed assets could go unaccounted for or be improperly recorded, leaving TSA and DHS vulnerable to fraud, waste, and abuse.

Another weakness reported by DOT's OIG was TSA's inadequate controls over security screener contracts. Policies and procedures were not established to provide an effective span of control to monitor contractor costs and performance. This lack of oversight enabled contractors to charge TSA up to 97 percent more than the contractors charged air carriers prior to the federalization of the screener workforce. This weakness provides further evidence of the importance of carefully documenting policies and procedures early in the implementation of a new organization.

Office of Domestic Preparedness

Established in 1998, the former Office of Domestic Preparedness (ODP) under DOJ's Office of Justice Programs provides grant funds and direct support to, among other things, help address the equipment, training, and technical assistance needs of state and local jurisdictions for responding to terrorism and terrorist-related activities.

[13]U.S. Department of Transportation, Office of Inspector General, *Quality Control Review of Audited Financial Statements for Fiscal Year 2002, TSA*, QC-2003-016 (Washington, D.C.: Jan. 27, 2003).

Since its inception, auditors have reported deficiencies in ODP's ability to administer grant funds.[14] In fiscal year 2002, we reported grant management as one of DOJ's major performance and accountability challenges.[15] DOJ's OIG has found that while millions of dollars had been awarded, the funds were not awarded expeditiously, and grantees were very slow to spend the requested monies.[16] According to the OIG, more than half of the monies requested and granted over the past few years remained unspent and some of the equipment purchased by state and local jurisdictions was unavailable for use because grantees did not properly distribute the equipment, could not locate it, or were inadequately trained to use it.

Since the DOJ OIG reported on this issue in fiscal year 2002, DHS has released more than $4.4 billion in grants to state and local governments and private sector organizations. This increased level of grants will only exacerbate these problems unless DHS works with grantees to improve the accountability over these funds.

Coast Guard

Unlike many of the larger agencies that transferred to DHS, the Coast Guard did not have a stand-alone financial statement audit, but was audited as part of DOT's consolidated audit. Although the auditors for DOT have not reported significant financial management weaknesses at the Coast Guard in recent years, the Coast Guard still uses DOT's Departmental Accounting and Financial Information System, which, among other things, was unable to produce auditable financial statements based on the information within the system. In addition, we have listed the Coast Guard as part of DHS's major management challenges due to its dual missions of maritime safety and homeland security.[17]

[14]U.S. Department of Justice, Office of Inspector General, *Office of Justice Programs: State and Local Domestic Preparedness Grant Programs*, 02-15 (Washington, D.C.: March 2002).

[15]U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Justice*, GAO-03-105 (Washington, D.C.: January 2003).

[16]U.S. Department of Justice, *Fiscal Year 2002 Performance and Accountability Report* (Washington, D.C.: Jan. 31, 2003).

[17]U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Homeland Security*, GAO-03-102 (Washington, D.C.: January 2003).

Concerns have also been reported regarding the Coast Guard's Deepwater Procurement Project, which currently has an estimated cost of $17 billion over 20 years. It is intended to replace or modernize by 2022 all assets used in missions that generally occur offshore. However, due to the events of September 11th and the Coast Guard's expanded role in homeland security, additional project requirements have been identified, including accelerating the project to be completed in 10 years. These changes may result in increased annual funding needs for the project, thus increasing the vulnerability to ineffective and inefficient use of funds.

Secret Service

The Secret Service, formerly under the Department of the Treasury (Treasury), has also not had a stand-alone financial statement audit, but was audited as part of Treasury's consolidated audit. Although from an audit perspective the Secret Service was relatively small in relation to the Internal Revenue Service and Bureau of the Public Debt at Treasury, its missions of protecting the President and investigating financial crimes are sensitive. Auditors for Secret Service may identify internal control weaknesses that were not previously known, but may now be identified since the Secret Service is proportionately a larger component of DHS than it was under Treasury, and may therefore be subjected to increased levels of audit scrutiny.

Other Entities

Aside from the known weaknesses at the 7 larger component agencies comprising DHS, some of the 15 smaller entities that transferred to DHS may also have weaknesses not previously identified. As with the Secret Service, these entities may be proportionately more significant at DHS than they were at their legacy departments. In addition, once combined, certain areas may be cumulatively subject to more audit scrutiny than when they were dispersed throughout other departments. Any such weaknesses will only exacerbate the extensive existing challenges.

Financial Reporting Challenges

DHS plans to prepare financial statements for the 7 months ending September 30, 2003. We support DHS's decision to do so, but recognize that it will be very challenging given the problems DHS inherited, compounded by the additional complexity of merging a number of diverse entities, which literally has had to hit the ground running from day one. Obtaining a consolidated DHS financial statement audit for that same period will be equally challenging, but also worthwhile.

Since DHS is a new entity, its auditors have already begun performing audit procedures on beginning balances (i.e., transferred balances) as of March 1, 2003, the activity for the 7 months ending September 30, 2003, and ending balances. The transfer date of March 1 represents a unique challenge because it does not fall on the end of a typical accounting period, such as the end of the fiscal year or reporting quarter. In addition, legacy departments' goals of reaching accelerated reporting dates[18] for fiscal year 2003 may be impaired if DHS cannot provide intragovernmental information needed by these departments on time. OMB and Treasury require agencies to reconcile selected intragovernmental activity and balances with their "trading partners" (i.e., other agencies) and to report on the extent and results of intragovernmental activity and balance reconciliation efforts. This information is necessary, not only for the agencies' financial statements and reports, but also for the U.S. Consolidated Financial Statements.

These are unique challenges that must be addressed to ensure that accounts and amounts transferred to DHS are complete and accurate and that legacy departments' reporting is not negatively impacted. Any significant problems encountered could also negatively impact the preparation and audit of the U.S. government's fiscal year 2003 financial statements.

In the longer term, DHS can only overcome its many challenges if it establishes systems, processes, and controls that help to ensure effective financial management and insists on the adherence to strong financial practices. In addition to addressing the many ongoing challenges existing in the programs of incoming agencies, DHS will need to focus on building future systems as part of its enterprise architecture approach to ensure an overarching framework for the agency's integrated financial management processes. Plans and standard accounting policies and procedures must be developed and implemented to bridge these financial environments into an integrated DHS system.

[18]The Office of Management and Budget (OMB) has issued accelerated reporting requirements that require agencies to prepare financial statements close to the end of the reporting period. Under these requirements, agency performance and accountability reports for fiscal year 2002 were due to OMB by February 1, 2003, and by fiscal year 2004 agencies will be required to submit these reports by November 15, 2004. In addition, in fiscal year 2003, agencies are required to prepare and submit quarterly financial statements no later than 45 days after the end of the reporting period.

Mr. Chairman, I would now like to discuss steps DHS should take to establish sound financial management and business processes.

Steps for Establishing Sound Financial Management and Business Processes

Successful financial management of DHS will depend on the department producing financial information that provides useful information for executive decision making. In April 2000, we issued an executive guide that provided guidance in creating value through financial management.[19] After studying the financial management practices and improvement efforts of nine leading private and public sector finance organizations, we identified several success factors, practices, and outcomes associated with world-class financial management. The organizations we studied include The Boeing Company, Chase Manhattan Bank, General Electric Company, Hewlett-Packard, Owens Corning, Pfizer Inc., and the states of Massachusetts, Texas, and Virginia.

First and foremost, establishing the following goals is key to developing a world-class finance organization with sound financial management and business processes: (1) make financial management an entitywide priority, (2) redefine the role of the finance organization, (3) provide meaningful information to decision makers, and (4) build a team that delivers results. I will discuss each of these goals in more detail below, including several best practices that are critical in meeting these goals. These practices lead to finance organizations that provide timely information that is relevant to management, useful in the decision-making process, and adds value to the organization. Since it is a newly created entity, DHS has a unique opportunity to implement the identified practices when developing financial policies and activities to establish sound financial management and business processes.

Establish Financial Management as an Entitywide Priority

Based on our study of world-class financial organizations, making financial management an entitywide priority is encouraged through the following best practices: (1) providing clear, strong, executive leadership, (2) building a foundation of control and accountability, and (3) using training to change the culture and engage line managers.

[19] U.S. General Accounting Office, *Executive Guide: Creating Value Through World-class Financial Management*, GAO/AIMD-00-134 (Washington, D.C.: April 2000).

Top leadership involvement is essential for a successful realignment of this magnitude. Top leadership is responsible for allocating the resources needed to improve financial management and for building and maintaining the organization's commitment to doing business in a new way. The CFO Act established the position of CFO in 24 agencies (app. I lists the original 24 CFO Act agencies—FEMA has transferred to DHS since the act was enacted) in the federal government. These CFOs are given oversight authority regarding financial management matters and are responsible for ensuring that sound financial management is in place. As you know, DHS is not currently subject to the provisions of the CFO Act, and thus has no legal requirement to comply with its provisions. Although Secretary Ridge pledged financial management as a priority in his May 1, 2003, testimony, passage of H.R. 2886, which would amend the CFO Act to include DHS, is important to ensure the department's long-term commitment to establishing sound financial management and business processes.

Further, as DHS continues to integrate its 22 entities, it must build a strong overall foundation of control and accountability. Management should begin by considering any significant control issues with agencies that are being integrated to form DHS, many of which I have already highlighted. These issues must be addressed within the specific agencies, as well as departmentwide to ensure they do not continue to be control issues within the newly formed department. Additionally, increases in accountability should be encouraged through the production of financial and performance reports for major programs on a regular and frequent basis to help in the decision-making process and strategic planning. Ultimately, the foundation for regular and frequent reporting will be through development of an integrated financial management system—one capable of capturing data at an appropriate level of detail and producing relevant and reliable information for users based on their needs. In the case of DHS, the challenge of combining, integrating, modernizing, and in some cases replacing the systems of many disparate agencies will require careful planning if the conversion is to be successful.

Redefine the Role of the Finance Organization

As discussed earlier, many of the larger agencies that transferred to DHS have a history of poor systems and inadequate financial management. In order to establish sound financial management and business processes, we found that world-class finance organizations redefined the role of the finance organization and implemented an integrated financial management structure that: (1) assessed the finance organization's role in meeting the department's mission, (2) maximized the efficiency of day-to-day

accounting activities, and (3) organized the finance organization to add value.

The ever-increasing competition for resources requires careful allocation of funds. Without the support of an effective finance organization, program managers may not be able to determine costs associated with government activities, defend those costs, or identify the benefits derived from them. The finance organization must understand the department's mission and be able to provide information in support of that mission. Of key importance is the ability of the finance organization to efficiently complete routine accounting activities, thus freeing resources to focus on other finance-related priorities that are in support of the department's mission. As I previously discussed, many of the larger agencies that transferred into DHS spend significant time preparing financial statements using manual work-arounds and have a history of poor financial management systems and significant internal control weaknesses. Such a time-consuming method of routine financial statement preparation does not allow for efficient use of finance staff. As DHS develops its financial management and businesses processes, it should focus on developing the abilities to (1) efficiently and effectively complete routine processing activities and (2) compile the data needed to measure performance so that information is available to management on a day-to-day basis.

Provide Meaningful Information for Decision Makers

The overarching goal of the President's Management Agenda is the improvement of government performance. The finance organization must play a pivotal role in providing decision makers with the information they need to measure performance. To efficiently and effectively provide reliable information to decision makers, we identified three best practices in our study of world-class finance organizations: (1) develop systems that support the partnership between finance and operations, (2) reengineer processes in conjunction with new technology, and (3) translate financial data into meaningful information.

To help agencies set goals and measure performance, the Congress enacted the Government Performance and Results Act (GPRA) in 1993. As part of GPRA, agencies, including DHS, are required to prepare a 5-year performance plan and annual performance reports. These required reports provide a strategic planning and management framework intended to improve federal performance and hold agencies accountable for achieving results. GPRA was intended, in part, to improve congressional decision making by giving the Congress comprehensive and reliable information on

the extent to which federal programs are fulfilling their statutory intent. Additionally, the President's Management Agenda includes improved financial management performance as one of the five governmentwide management goals. This initiative is aimed at ensuring that federal financial systems produce accurate and timely information to support operating, budget, and policy decisions. The finance organization is a key component of a department's ability to meet its requirements under GPRA and the objectives of the President's Management Agenda.

Build an Effective Finance Team

Over the years, the federal government has had difficulty attracting and retaining talented financial management officials. Improving financial performance is difficult without experienced leadership and staff who are committed to success. Our study of several world-class finance organizations indicated the following as best practices to build a team that can deliver results: (1) develop a finance team with the right mix of skills and competencies, and (2) attract and retain talent.

Given the current demand on resources and the competition for qualified employees, developing and retaining a talented finance team that is capable of meeting the changing demands of the federal financial workplace is an important goal. The lack of highly qualified financial management professionals can hamper effective federal financial management operations. The CFO Act requires OMB's Deputy Director for Management to develop and maintain qualification standards for agency CFOs and their deputies; provide advice to agencies on the qualification, recruitment, performance, and retention of financial management personnel; and assess the adequacy of financial management staffs throughout the government. Additionally, the CFO Act places responsibility with the CFO to recruit, select, and train finance personnel.

To help department leaders manage their people and integrate human capital considerations into daily decision making and the program results they seek to achieve, we developed a strategic human capital model.[20] This model is applicable to department leadership as a whole but is also applicable to finance organization leadership as they seek to attract, develop, and retain talent. The two critical success factors identified in our model to assist organizations in creating results-oriented cultures are

[20]U.S. General Accounting Office, *A Model of Strategic Human Capital Management*, GAO-02-373SP (Washington, D.C.: Mar. 15, 2002).

(1) linking unit and individual performance to organizational goals and (2) involving employees in the decision-making process. Agency leaders have other opportunities for displaying their commitment to human capital. Continuous learning efforts, employee-friendly workplace policies, competency-based performance appraisal systems, and retention and reward programs are all ways in which agencies can value and invest in their human capital. The sustained provision of resources for such programs can show employees and potential employees the commitment agency leaders have to strategic human capital management. DHS should adopt these success factors in building a financial management team that delivers results.

It is well recognized that mergers of the magnitude of DHS carry significant risks, including lost productivity and inefficiencies. Successful transformations of large organizations generally can take from 5 to 7 years to achieve. Necessary management capacity, communication and information systems, as well as sound financial management and business processes must be established. Though creating and maintaining these structures will be demanding and time consuming, it is necessary to effectively implement the national homeland security strategy.[21]

Over the past several months, we have met with DHS's CFO, Acting Inspector General and Assistant Inspector General for Audits, and its independent auditors performing its financial statement audit for 2003. We are committed to working in a coordinated effort with the Congress, DHS, and its auditors to provide advice to DHS on developing a sound financial management structure that will facilitate, and not hamper, its mission of securing the homeland. We believe that passage of H.R. 2886 will further assist DHS in meeting this goal.

Comments on H.R. 2886

Mr. Chairman, as you know, H.R. 2886 as introduced on July 24, 2003 would amend the CFO Act to (1) add DHS as a CFO Act agency and remove FEMA as a CFO Act agency, (2) require DHS to obtain an audit opinion on its internal controls, and (3) require DHS to include program performance

[21]GAO convened a forum on September 24, 2002, to identify and discuss useful practices and lessons learned from major private and public sector organizational mergers, acquisitions, and transformations. U.S. General Accounting Office, *Highlights of a GAO Forum: Mergers and Transformation: Lessons Learned for a Department of Homeland Security and Other Federal Agencies*, GAO-03-293SP (Washington, D.C.: November 2002).

information in its performance and accountability reports. In addition, H.R. 2886 as introduced would have provided a waiver allowing DHS to forego a financial statement audit for fiscal year 2003. We understand an agreement has been reached to remove this waiver from the proposed legislation. DHS's 2003 audit is already underway and the department has stated it is committed to obtaining this audit. The waiver option is, therefore, no longer needed, and we support dropping the provision from H.R. 2886.

Inclusion of DHS as a CFO Act Agency

We supported passage of the CFO Act in 1990 and continue to strongly support its objectives of (1) giving the Congress and agency decision makers reliable financial, cost, and performance information both annually and, most important, as needed throughout the year to assist in managing programs and making difficult spending decisions, (2) dramatically improving financial management systems, controls, and operations to eliminate fraud, waste, abuse, and mismanagement and properly safeguard and manage the government's assets, and (3) establishing effective financial organizational structures to provide strong leadership. Achieving these goals is critical for establishing effective financial management, and we fully support amending the CFO Act to include DHS.

In developing the CFO Act, the Congress viewed the CFO as being a critical player in the management of an agency. At the time, financial management was not a priority in most federal agencies and was all too often an afterthought. All too often, the top financial management official wore many hats, which left little time for financial management; did not necessarily have any background in financial management; and focused primarily on the budget. By establishing statutorily the position of CFO, requiring that the person in the position have strong qualifications and a proven track record in financial management, and giving this person status as a presidential appointee, the Congress sought to change the then existing paradigm. Of the 24 agencies named in the 1990 CFO Act, 16 were designated as Level IV, Presidential appointee Senate confirmation positions and eight were career positions. Today, CFOs have become influential across government and the quality of the appointees has borne out the wisdom of the Congress's insistence that this position be elevated (meaning it reported to the top and had standing with other top officials). We have seen an evolution of the CFO position and a quantum change in the expertise and abilities of CFOs and the attractiveness of this position to someone having the type of proven track record in financial management that is needed in the federal government. In the end, the key attribute is the quality of the person in the position to affect change and carry out the role

of CFO and whether the head of the agency supports the CFO and empowers that person to do the job needed. Appointment of the CFO by the President, subject to Senate confirmation, is one way to help ensure that the goals of the CFO Act are met and that has proven itself over time.

The CFO Act, as expanded by the Government Management Reform Act of 1994, also requires agencies to prepare and have audited financial statements. The Congress added further emphasis to the importance of sound financial management when it enacted FFMIA. Under the Accountability of Tax Dollars Act of 2002,[22] DHS, as an executive branch agency with budget authority greater than $25 million, would be required to obtain annual financial statement audits; however, its auditors would not have to report on compliance with FFMIA. Although DHS has appropriately contracted with independent auditors to report on its systems compliance with FFMIA for fiscal year 2003, it is not legally required to do so. FFMIA requires that agencies implement and maintain financial management systems that substantially comply with (1) federal systems requirements, (2) federal accounting standards, and (3) the U.S. Government Standard General Ledger. The ability to produce the data needed to efficiently and effectively manage the day-to-day operations of the federal government and provide accountability to taxpayers has been a long-standing challenge at most federal agencies. As we discussed earlier, auditors reported that many of the larger agencies that transferred to DHS were not in substantial compliance with FFMIA prior to their transfer to DHS. Given these preexisting compliance issues, in addition to issues that may arise with system integration initiatives, it is critical that DHS be legally required to comply with these important financial management reforms.

Opinion on Internal Controls

Current OMB guidance for audits of government agencies and programs[23] requires auditor reporting on internal control, but not at the level of providing an opinion on internal control effectiveness. However, we have long believed and the Comptroller General has gone on record in

[22] Pub. L. No. 107-289, 116 Stat. 2049 (2002).

[23] Office of Management and Budget, *Audit Requirements for Federal Financial Statements*, Bulletin 01-02 (Washington, D.C.: Oct. 16, 2000).

congressional testimony[24] that auditors have an important role in providing an opinion on the effectiveness of internal control over financial reporting and compliance with laws and regulations in connection with major federal departments and agencies. For a number of years, we have provided separate opinions on internal control effectiveness for the federal entities that we audit because of the importance of internal control to protecting the public's interest. Specifically, we provide separate opinions on internal controls and compliance with laws and regulations for our audits of the U.S. government's consolidated financial statements, the financial statements of the Internal Revenue Service and Federal Deposit Insurance Corporation, the Schedules of Federal Debt managed by the Bureau of the Public Debt, and numerous small entities' operations and funds. Our reports and related efforts have engendered major improvements in internal control.

As part of the annual audit of our own financial statements, we practice what we recommend to others and contract with an independent public accounting firm for both an opinion on our financial statements and an opinion on the effectiveness of our internal control over financial reporting and compliance with laws and regulations. Our goal is to lead the way in establishing the appropriate level of auditor reporting on internal control for federal agencies, programs, and entities receiving significant amounts of federal funding. Additionally, three agencies, Social Security Administration (SSA), General Services Administration (GSA), and the Nuclear Regulatory Commission (NRC) voluntarily obtain separate opinions on internal control effectiveness from their auditors, which is commendable.

Another consideration as the Congress decides whether to enact new requirements is that an opinion on internal controls is what has been prescribed by the Congress for publicly traded corporations. A final rule issued by the Securities and Exchange Commission in June 2003 and effective in August 2003 provides guidance for implementation of Section 404 of the Sarbanes-Oxley Act of 2002,[25] which requires publicly traded companies to establish and maintain an adequate internal control structure and procedures for financial reporting and include in its annual report a

[24]U.S. General Accounting Office, *Fiscal Year 2002 U.S. Government Financial Statements: Sustained Leadership and Oversight Needed for Effective Implementation of Financial Management Reforms*, GAO-03-572T.

[25]Pub. L. No. 107-204, 116 Stat. 745 (2002).

statement of management's responsibility for and management's assessment of the effectiveness of those controls and procedures in accordance with standards adopted by the Securities and Exchange Commission. The final rule defines this requirement and requires applicable companies to obtain a report in which a registered public accounting firm expresses an opinion, or states that an opinion cannot be expressed, concerning management's assessment of the effectiveness of internal controls over financial reporting.

Auditor reporting on internal control is a critical component of monitoring the effectiveness of an organization's accountability. GAO strongly believes that this is especially important for very large, complex, or challenged entities. By giving assurance about internal control, auditors can better serve their clients and other financial statement users and better protect the public interest by having a greater role in providing assurances of the effectiveness of internal control in deterring fraudulent financial reporting, protecting assets, and providing an early warning of internal control weaknesses. We believe auditor reporting on internal control is appropriat and necessary for publicly traded companies and major public entities alike. We also believe that such reporting is appropriate in other cases where management assessment and auditor examination and reporting on the effectiveness of internal control add value and mitigate risk in a cost-beneficial manner.

We know that some will point to increased costs as a reason to remove this provision from the legislation. We believe that auditors who follow the *Financial Audit Manual*—which was jointly developed by GAO and the President's Council on Integrity and Efficiency (PCIE)[26]—should ordinarily have little to no incremental costs associated with such reporting.

We fully support having DHS, as well as all CFO Act agencies, obtain an opinion on its internal control. If DHS is truly committed to becoming a model federal agency, it should begin obtaining opinions on internal control as soon as practical and set an example for other agencies to follow and in keeping with the actions already taken by SSA, GSA, NRC, and GAO.

[26]Generally referred to as the GAO/PCIE *Financial Audit Manual*.

Inclusion of Performance Information in Accountability Reports

We also support agencies including program performance information in agency performance and accountability reports, so that relevant performance and financial information is presented in a consolidated and useful manner. Agencies currently have the discretion to include this information in a consolidated format. We strongly encourage DHS to consolidate this information in its accountability report beginning with fiscal year 2003.

In closing, the American people have increasingly demanded accountability from government and the private sector. The Congress has recognized, through legislation such as the CFO Act, that the federal government must be held to the highest standards. We already know that many of the larger agencies transferred to DHS have a history of poor financial management systems and significant internal control weaknesses. These known weaknesses provide further evidence that DHS's systems and financial controls should be subject to provisions of the CFO Act and thus FFMIA. We also strongly encourage DHS to become a model agency and, as soon as practical, obtain an opinion on its internal controls and report performance information in its accountability reports.

Mr. Chairman, this concludes my statement. I would be happy to answer any questions you or other Members of the Subcommittee may have at this time.

Contacts and Acknowledgments

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CFO Act Agencies

24 CFO Act Agencies

The Department of Agriculture
The Department of Commerce
The Department of Defense
The Department of Education
The Department of Energy
The Department of Health and Human Services
The Department of Housing and Urban Development
The Department of Interior
The Department of Justice
The Department of Labor
The Department of State
The Department of Transportation
The Department of the Treasury
The Department of Veterans Affairs
The Environmental Protection Agency
The National Aeronautics and Space Administration
The Agency for International Development
The Federal Emergency Management Agency[1]
The General Services Administration
The National Science Foundation
The Nuclear Regulatory Commission
The Office of Personnel Management
The Small Business Administration
The Social Security Administration

[1]Under the Homeland Security Act of 2002, FEMA transferred to DHS and under H.R. 2886 would no longer be considered a CFO Act agency.

Related GAO Products

Fiscal Year 2002 U.S. Government Financial Statements: Sustained Leadership and Oversight Needed for Effective Implementation of Financial Management Reform. GAO-03-572T. Washington, D.C.: April 8, 2003.

Transportation Security Administration: Actions and Plans to Build a Results-Oriented Culture. GAO-03-190. Washington, D.C.: January 2003.

High-Risk Series: An Update. GAO-03-119. Washington, D.C.: January 2003.

Major Management Challenges and Program Risks: Federal Emergency Management Agency. GAO-03-113. Washington, D.C.: January 2003.

Major Management Challenges and Program Risks: Department of the Treasury. GAO-03-109. Washington, D.C.: January 2003.

Major Management Challenges and Program Risks: Department of Justice. GAO-03-105. Washington, D.C.: January 2003.

Major Management Challenges and Program Risks: Department of Homeland Security. GAO-03-102. Washington, D.C.: January 2003.

Financial Management: FFMIA Implementation Necessary to Achieve Accountability. GAO-03-31. Washington, D.C.: October 1, 2002.

Homeland Security: Critical Design and Implementation Issues. GAO-02-957T. Washington, D.C.: July 17, 2002.

A Model of Strategic Human Capital Management. GAO-02-373SP. Washington, D.C.: March 2002.

Executive Guide: Creating Value Through World-class Financial Management. GAO/AMID-00-134. Washington, D.C.: April 2000.

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Mr. PLATTS. Thank you, Mr. Williams.

I would like to recognize the ranking member, Mr. Towns, arrival. Thank you for joining us.

Dr. Carnes.

STATEMENT OF BRUCE CARNES, CHIEF FINANCIAL OFFICER, DEPARTMENT OF HOMELAND SECURITY

Mr. CARNES. Thank you, Mr. Chairman and members of the subcommittee.

I am pleased to be here to talk about the challenges that we in DHS face in financial management and business processes and our progress in addressing them.

As CFO of the Department of Homeland Security, I am committed to building financial policies, processes and systems that are a model for the Federal Government. We have already done a lot since we were established in bringing the financial policies, processes and systems of 22 disparate organizations into one department.

In March we successfully transferred more than $50 billion in assets, $36 billion in liabilities, and 180,000 employees into the department. Within a few weeks, we created the financial structures and support systems necessary to support these transfers. We have consolidated our bank card programs to reduce the number of programs within the department from 27 to 3. We created an Investment Review Board to evaluate acquisitions above $5 million; we are requiring certified project managers to be in charge of our projects. We have initiated a 5-year budget and planning program. We have established a budget development process modeled after DOD's POM process, the Program Objectives Memorandum Process. We created a PA&E—program analysis and evaluation—organization charged with ensuring compliance with performance and accountability requirements. We are developing a Future Year's Homeland Security Plan and we have launched a consolidated business and financial management systems program.

Currently the department has 22 disparate financial processes. Beginning October 1 of this year, we are going to shrink that by more than 50 percent from 22 to 10, primarily by bringing in-house and sharing services the work that is done by other entities right now.

We are studying ways to further streamline the financial processes used by the department with the goal of enhancing efficiency, reducing cost and improving the quality of financial data. We have 83 financial systems at the last count, few of which are integrated. Some are outdated, lack functionality and are expensive to operate and maintain.

This puts me on familiar territory because for 10 years between 1990 and 2000, I worked for the Defense Finance and Accounting Service, which is the largest finance and accounting organization in the world and does all the financial operations for the Department of Defense and this is exactly the problem DOD had, that DFAS tackled and I think has done a very successful job. Before I left DFAS, I was the Chief Operating Officer there so this is very analogous though smaller than the problems you see at DOD.

As part of our systems initiative, we are going to develop and implement a departmental business and financial enterprise solution that results in a single suite of financial systems for DHS. I want to create the financial equivalent of a global positioning system so that our program managers will know at any minute exactly where they are when it comes to financial and other business matters.

We are launching a comprehensive review of the financial operations of all DHS components. This will include a review of performance standards, business processes, workload requirements and so on. It will provide recommendations for establishing departmentwide performance standards, improved processes, possible consolidations and systems enhancements and improvements.

Another challenge we face is preparing consolidated financial statements. As already noted, we prepared our interim quarterly financial statements on time. We will have a consolidated financial statement for the department delivered November 15, ahead of schedule.

Part of the challenge is mitigating the impact of 18 inherited material weaknesses that came to us from the agencies we inherited. We have addressed them, we have plans for correcting all of those situations.

In closing, I want to assure the committee that DHS is advancing as rapidly and judiciously as we can toward becoming a model for financial management excellence. We have set ambitious goals, we have set high standards of achievement. In the coming months, we will move aggressively to implement the plans I have described.

This all hinges on support from above which I have in plentitude and I have an outstanding staff of experts who have been through this before and know exactly what they are doing, so I am very confident that we will reach our goal.

That ends my testimony. I would be happy to take any questions.

[The prepared statement of Mr. Carnes follows:]

Statement of Bruce M. Carnes
Chief Financial Officer
Department of Homeland Security
Before the House Committee on Government Reform
Subcommittee on Government Efficiency and Financial Management

Mr. Chairman, members of the Subcommittee, I am pleased to be here to discuss our progress and challenges in building financial management and business processes at the Department of Homeland Security.

DHS Financial Management Accomplishments and Goals

The Department of Homeland Security was created to protect the American people by preventing terrorist attacks, reducing our vulnerability to attack, and minimizing the loss of life and speeding recovery should one occur. At the same time, the Administration saw the creation of the Department as an opportunity to build a model for management excellence by efficiently and effectively managing resources to deliver measurable results.

As the Chief Financial Officer at the Department of Homeland Security, I am committed to fulfilling this vision by building financial policies, processes, and systems that are a model for the Federal government. Just as we have consolidated border and transportation security functions, merged response activities, integrated terrorist threat intelligence, and coordinated homeland security research and development efforts, I believe we must with equal vigor transform our business practices and systems.

Since the Department was established, much has already been done to bring the financial policies, processes, and systems of 22 disparate organizations into one Department. In March 2003, we successfully transferred more than $50 billion in assets,

$36 billion in liabilities, and more than 180,000 employees to the Department. Within a few weeks, we created the financial structures and support systems necessary to support these transfers. This was accomplished with only handful of staff -- a remarkable achievement of which we are proud.

We have also launched a consolidated bankcard program that will reduce the number of programs within the Department from 27 to three, created an investment review board to evaluate acquisitions above $5 million, initiated a five-year budget and planning program, established a budget process modeled after the Department of Defense's Program Objectives Memorandum process, created a Program Analysis and Evaluation organization charged with ensuring compliance with performance and accountability requirements, and launched a consolidated business and financial management systems program.

Our success in these areas has laid a solid foundation for our efforts to become a model of excellence in Federal financial management; however, much remains to be done. As we move forward, using the President's Management Agenda as our guide, we seek to:

- increase efficiency and effectiveness by producing financial data that is timely, reliable, and useful to decision makers;
- strengthen accountability by ensuring that internal controls are in place across the Department and appropriate oversight reviews are conducted; and
- significantly reduce costs by consolidating functions, systems, and processes and by instituting best business practices.

These goals are ambitious and we face significant challenges in achieving them.

DHS Financial Management Challenges and Solutions

Consolidating the Department's 22 Financial Processes. Currently, the Department has 22 disparate financial processes. Several of these were established through memorandums of understanding with the Department's legacy agencies. Using these processes helped ensure sufficient financial support services were available when the Department was first established. However, they are labor-intensive and cumbersome to manage. Beginning October 1, 2003, we are consolidating the number of processes from 22 to10 – primarily by terminating the memorandums of understanding with legacy agencies and by shifting the workload to in-house financial support service units.

This is only a good start. In FY 2004, we will consider options to further streamline the financial processes used by the Department with the goal of enhancing efficiency, reducing costs, and improving the quality of financial data.

Multiple and Redundant Financial Systems. The Department has 83 financial management systems, few of which are integrated. Some are outdated, lack functionality, and are expensive to operate and maintain. To tackle this problem, we have launched an aggressive program to transform the Department's business and financial management policies, processes, and systems.

As part of this initiative, we will develop and implement a departmental business and financial enterprise solution that results in a single suite of financial management systems for the Department. The objective of the program is to provide the business equivalent of a Global Position System that will:

- Provide decision-makers with the business information (e.g., budget, accounting, personnel, procurement, travel) they need in near real-time;
- Improve data quality and timeliness;
- Provide required information to our stakeholders, including the Office of Management and Budget, the Congress, the General Accounting Office, our Inspector General, and the public; and
- Help the Department obtain a clean opinion on our financial statements.

This program will have a major impact on the way the Department manages its business and financial operations and will result in the Department's becoming more efficient and effective by eliminating redundant systems and consolidating functions. Developing and implementing the envisioned suite of systems will require a substantial up-front investment; however, once implemented, we anticipate that this program will produce significant cost savings.

Lack of Standard Business Practices. Just as the Department has multiple financial systems and processes, we have multiple business practices for managing our financial operations. While some diversity is desirable to ensure that innovation thrives and best practices emerge, some standardization is also necessary.

Thus, we are launching a comprehensive review of the finance and accounting operations of all Department of Homeland Security components. The review will include an assessment of performance standards, business processes, workload requirements, systems capabilities, staffing requirements, and productivity levels. The review will also provide recommendations for establishing department-wide performance standards, improved business process, possible consolidations, and systems improvements. Action

plans will be developed to implement recommendations. We anticipate that the Department will begin to realize cost savings from implementing the recommendations as early as FY 2005.

Challenges Relating to Coordination and Communication. In any organization as large as the Department of Homeland Security, communication and coordination can be a challenge. To tackle this problem, early in my tenure I established a departmental Chief Financial Officer's Council, which I chair, and whose members include the budget and finance directors from the Department's components. The Council has been instrumental in sharing information and priorities and for discussing the problems confronting the components.

While the Council has been effective in providing direction to the budget and finance officers, the fact remains that they are part of a different command structure. While this has not been detrimental to accomplishing the initiatives that we have pursued thus far, as we begin to make the sweeping changes needed to become a model for financial management excellence, working within the current structure could become a greater challenge.

Preparing Consolidated Financial Statements. Another challenge we face is preparing consolidated financial statements for the first time on the accelerated schedule established by the Office of Management and Budget (November 15, 2003). Although this is a formidable challenge, we decided early on that the Department needed to move aggressively to meet the requirements of OMB Bulletin-01-09, as amended, which requires agencies to prepare financial statements on an accelerated schedule. We have

prepared our interim statements on time and plan to meet the November 15 accelerated due date for the final statement.

Part of the challenge that we face in preparing our statements is mitigating the impact of 18 inherited material weaknesses that were identified in prior-year audits at the Department's legacy agencies. To tackle this problem, I directed the Department's components to establish corrective action plans for each material weakness. I also established a system to monitor implementation in which the components report to me on a quarterly basis on their progress in correcting their material weaknesses. In addition, I am creating a unit within my organization to conduct internal audits, some of which will be focused on any material weaknesses that are not being corrected on schedule. Through these processes, I believe that we will make significant progress in reducing the number of material weaknesses and ultimately eliminate them.

H.R. 2886 "Department of Homeland Security Financial Accountability Act"

As the CFO of the Department of Homeland Security, I applaud the spirit with which H.R. 2886, "Department of Homeland Security Financial Accountability Act", was introduced. I agree with the bill's sponsor, Congressman Platts, that increased accountability is important and necessary as demonstrated by the continuing rash of corporate accounting scandals.

While I agree with the overarching goal that H.R. 2886 seeks to accomplish, I do not believe that legislation is necessary. Section 2 of the bill proposes to subject the Department to the same financial management and accountability requirements as all other cabinet-level departments. It also proposes to change the status of the Chief

Financial Officer from a presidential appointee reporting to an under secretary to a presidential appointee subject to Senate confirmation reporting to the Secretary.

As the Department's CFO, I have the same duties and responsibilities as CFOs in other agencies and am held accountable for ensuring the Department's financial integrity in the same manner. The proposed legislation will not change the way I perform my job nor will it give me any authority that I do not already have. Similarly, the legislation will not change the requirements the Department must comply with in accounting for its finances. The Department complies with the provisions of the Chief Financial Officers Act of 1990 and will continue to do so.

Section 3 of H.R. 2886 provides the Secretary of Homeland Security with the option to prepare or submit an audited financial statement before Fiscal Year 2004. Early in my tenure, I determined that the Department should move aggressively to subject itself to the same financial management and accountability requirements as other cabinet-level agencies. Therefore, we will prepare auditable financial statements for Fiscal Year 2003. This decision was supported by our Inspector General. The audit is well underway and we plan to submit our consolidated financial statements to the Office of Management and Budget in November, two and one-half months before they are due. We will publish the Department's Performance and Accountability Report as soon as the Office of the Inspector General completes its audit of our financial statements, in January 2004 at the latest.

Section 3 also includes a provision that would require that the Department's performance and accountability report to include an audit opinion of the Department's internal controls over its financial reporting. Although an audit of internal controls is

useful in some circumstances, we do not support the notion that an audit of the Department's system of internal controls is generally warranted. Such an audit would be redundant with standard testing of controls associated with financial statement audits and with the management reviews conducted under the Federal Managers' Financial Integrity Act (FMFIA). An audit of internal controls would be costly and place excess demands on limited staff. We believe that audits of internal controls should be reserved for special and unique situations where waste, fraud and abuse or misstatements are identified in the course of other audits or internal reviews, inspections or evaluations.

Again, I support the intent of the proposed legislation. Should H.R. 2886 be deemed as necessary, the Department would look forward to working closely with the Congress on this important issue.

Closing

In closing, I want to assure this committee that the Department of Homeland Security is advancing as rapidly and judiciously as possible toward our goal of becoming a model for financial management excellence. We have set ambitious goals for ourselves and high standards of achievement. In the coming months, we will move aggressively to implement the plans that I have described for consolidation, streamlining, and increasing accountability. We will also announce further plans to help us reach these goals.

We look forward to working with the Congress as we progress with our plans and will seek your continued support as we move forward.

Mr. PLATTS. Thank you, Mr. Carnes.
Mr. Berman.

STATEMENT OF RICHARD BERMAN, ASSISTANT INSPECTOR GENERAL FOR AUDIT, DEPARTMENT OF HOMELAND SECURITY

Mr. BERMAN. Thank you for the opportunity to be here today to discuss financial management at the Department of Homeland Security and H.R. 2886.

On March 1, 2003, DHS was created by consolidating 22 disparate domestic agencies to better protect the Nation against threats to the homeland. Each of the component agencies brought to DHS its distinct business processes, some with major financial weaknesses, which presents DHS with challenges in integrating operations, creating a common infrastructure, and developing goals, objectives and meaningful performance measures to guide and track progress. All of these challenges impact financial management at DHS.

In the area of financial systems and reporting, DHS must integrate and establish effective controls over financial systems and operations of incoming components, including correcting weaknesses it has inherited. For example, some components such as INS have received unqualified audit opinions on their financial statements but expended tremendous human resources and cost to prepare financial statements because of their inadequate financial systems and the weaknesses that we have inherited.

DHS inherited a total of 18 material weaknesses identified in prior year financial statements. We will be assessing these material weaknesses, and the need to retain or add to them, as part of our fiscal year 2003 financial statement audit. Information systems are a key that DHS must address in order to establish sound financial management and business processes. The 83 systems the CFO cited present huge opportunities to achieve greater economy and efficiency in this area. To meet these challenges, DHS will need to build a unified financial management structure capable of supporting both efficient financial statement preparation and reliable and timely financial information for managing DHS' current operations.

Grants and contracts management are also major areas of concern to OIG. DHS awards over $7 billion annually in grants under its Emergency Preparedness and Disaster Assistance Grant Programs which were absorbed primarily from FEMA and the Department of Justice. Previous FEMA and DOJ Office of Inspector General [OIG] reports identified significant shortcomings in the preaward process, cash management, monitoring, and grant closeout processes in the emergency preparedness programs. Each of these programs has redundant or similar features such as emergency planning, training, and equipment purchases and upgrades for State and local emergency personnel. Meaningful performance measures are desperately needed.

Additionally, FEMA's OIG found that FEMA had ineffective performance and financial oversight over its disaster assistance grants, which in turn enabled grant recipients and subgrantees to misuse millions of dollars in Federal funds which the FEMA IG reported. A sound grants management program is needed, one that

complies with Federal requirements and includes effective monitoring of and assistance to States and other grantees.

Similarly, DHS absorbed billions of dollars in contracts from the component agencies that were awarded under differing procedures and circumstances. DHS must integrate the procurement functions of several legacy agencies, some lacking important management controls. For example, at TSA, where contracts totaled $8.5 billion at the end of calendar year 2002, the Department of Transportation OIG found that procurements were made in an environment where there was no pre-existing infrastructure for overseeing contracts. TSA had to rely extensively on contractors to support its mission, leading to tremendous growth in contract costs. Also, some DHS components have large, complex, high-cost procurement programs under way that need to be closely evaluated and managed. Our office is currently reviewing several large DHS contracts including TSA's airport screener contract, Customs' automated commercial environment project, and we are tracking closely the Coast Guard's Deepwater Procurement Program.

Early attention by DHS to strong systems and controls for acquisition and related business processes will be critical, both to ensuring success of programs and maintaining integrity and accountability.

With regard to H.R. 2886, our primary concerns relate to provisions to waive the audit requirement for 2003, which we are thankful has now been dropped, and a requirement for the opinion on internal controls in fiscal year 2004. As we have noted, we believe the audit for 2003 is very important and will produce important benefits.

Recording the opinion on internal controls, the IG believes that such a requirement would be beneficial, but that it is not practical to perform an audit of internal controls in fiscal year 2004 as the bill would require. There are two reasons. First, fundamental to rendering an opinion on internal control is "management's assertion" on controls over financial reporting. Based on what we understand of new standards currently proposed by the American Institute of CPAs in response to the Sarbanes-Oxley Act of 2002, this could be or would be an extensive, time consuming process requiring sufficient time to implement.

Second, and also based on what we understand regarding the proposed new standards, there would be significant additional procedures and costs to render such an opinion on internal controls, particularly in light of the complexity inherent in DHS' situation. The size of the cost increment would depend on the extent of the evaluation and testing performed by DHS and the audit approach we choose for financial statements.

In the private sector, one survey found that the cost of complying with the internal control reporting requirements of Sarbanes-Oxley would increase the average audit costs by 35 percent. If no new funding is provided for this purpose, some difficult choices will have to be made by our office.

Mr. Chairman, this concludes my remarks. I would be happy to answer questions you may have.

[The prepared statement of Mr. Berman follows:]

STATEMENT OF J. RICHARD BERMAN

ASSISTANT INSPECTOR GENERAL FOR AUDITS

OFFICE OF INSPECTOR GENERAL

U. S. DEPARTMENT OF HOMELAND SECURITY

BEFORE THE

COMMITTEE ON GOVERNMENT REFORM

SUBCOMMITTEE ON GOVERNMENT EFFICIENCY

AND FINANCIAL MANAGEMENT

U. S. HOUSE OF REPRESENTATIVES

SEPTEMBER 10, 2003

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to be here today to discuss financial management at the Department of Homeland Security (DHS) and H.R. 2886, *The Department of Homeland Security Financial Accountability Act.*

On March 1, 2003, DHS was created by consolidating 22 disparate domestic agencies to better protect the nation against threats to the homeland. In order for DHS to accomplish its multiple missions, it has organized these 22 agencies into four major directorates. The Border and Transportation Security Directorate, which maintains the security of our nations' borders and transportation systems, is the largest and consists of several legacy agencies, including the Transportation Security Administration (TSA), the U.S. Customs Service, the Office of Domestic Preparedness (ODP), and law enforcement functions, such as the Border Patrol, of the Immigration and Naturalization Service (INS). The Emergency Preparedness and Response Directorate is primarily the former Federal Emergency and Management Agency (FEMA), and ensures that our nation is able to recover from terrorist attacks and natural disasters.

Smaller agencies were incorporated into the above directorates as well as the Science and Technology and Information Analysis and Infrastructure Protection Directorates. Additionally, the Coast Guard and Secret Service retained their distinct identities within DHS. The newly created Bureau of Citizenship and Immigration Services will assume the responsibility for immigration services from the former INS. Providing the infrastructure to hold the department together is the Management Directorate, which is responsible for budget, management, and personnel activities.

Each of the component agencies brought to DHS its distinct business processes, which presents DHS with challenges in integrating operations, creating a common infrastructure, and developing goals, objectives and meaningful performance measures to guide and track progress. All of these challenges impact financial management at DHS.

Financial management in the federal government revolves around requirements found in several laws, including the Federal Managers Financial Integrity Act, the Chief Financial Officers Act, the Federal Financial Management Improvement Act (FMFIA), and the Government Performance and Results Act. Agencies must ensure that: (1) government obligations and costs are lawful; (2) funds, property, and other assets are safeguarded; (3) reliable, timely, and useful information is available to make fully informed decisions and to provide accountability; and (4) performance is measured.

Following is an overview of the major financial management challenges facing DHS, along with the steps we believe are needed to address these challenges and establish sound financial management and business processes at DHS. We provide substantive comments on H.R. 2886 as well.

OVERVIEW OF FINANCIAL MANAGEMENT CHALLENGES AND SOLUTIONS

Financial Systems and Reporting

DHS must integrate and establish effective controls over the financial systems and operations of the incoming components, many of which bring with them longstanding weaknesses in need of correction. DHS inherited a total of 18 material weaknesses identified in prior year financial statement audits at the legacy agencies. I have included a list and brief description of these weaknesses as an appendix to my statement. We will be assessing these material weaknesses, and the need to retain or add to them, as part of our FY 2003 financial statement audit.

Correcting such weaknesses presents a major challenge. For example, some components, such as INS[1], have received unqualified audit opinions on their financial statements, but expended tremendous human resources and costs to prepare their financial statements, and weaknesses existed in financial systems and controls. In the past, INS has halted normal business operations for up to two weeks each year in order to conduct manual counts of millions of applications in order to calculate earned revenue figures for its annual financial statements. Poor, unconnected databases were a major cause of these costly efforts.

While combining the 22 entities and their myriad financial systems and processes pose complex challenges, opportunities abound to achieve greater economy and efficiency. Information systems are a key issue that DHS must address in order to establish sound financial management and business processes. Many of the smaller agencies that came into DHS are still supported by their legacy agency systems and will need to migrate to a DHS platform. The larger agencies brought their own processing capability, but several of these systems have material weaknesses involving system functionality and security. Overall, DHS inherited over 100 financial management systems.

To meet these challenges, DHS will need to build a unified financial management structure, including integrated and compliant systems as well as consistent policies and procedures. These systems must support not only efficient financial statement preparation; they must provide reliable and timely financial information for managing DHS' current operations, too. A key factor will be the sustained commitment of top DHS leadership, which the Chief Financial Officer (CFO) already has demonstrated. The CFO meets regularly with financial officers and staff from DHS components and legacy agencies that still provide accounting support to discuss the continuing transition and current DHS-wide financial management issues. Further, the CFO has formed a group to develop financial system requirements for the agency in coordination with the office of the Chief Information Officer.

[1]Within DHS, INS has been broken apart and joined with the Bureau of Customs and Border Protection and the Bureau of Immigration and Customs Enforcement. Another part formed the Bureau for Citizenship and Immigration Services.

Grants Management

DHS awards over $7 billion annually in grants under its emergency preparedness and disaster assistance grants programs.

DHS absorbed three major emergency preparedness grant programs from FEMA and the Department of Justice (DOJ): the First Responder Program - $3.2 billion; the Assistance to Firefighters Grant Program - $750 million; and the Emergency Management Performance Grant Program - $165 million. DHS also absorbed about $450 million in miscellaneous emergency preparedness grant programs. Previous FEMA and DOJ Office of Inspector General (OIG) reports identified significant shortcomings in the pre-award process, cash management, monitoring, and grant closeout processes. Each of these programs has redundant or similar features such as emergency planning, training, and equipment purchases and upgrades for state and local emergency personnel. Furthermore, program managers need to develop meaningful performance measures related to the degree to which the DHS grant programs have enhanced state and local capabilities to respond to terrorist attacks and natural disasters.

Another complication is that these programs have been divided between two separate DHS directorates. Preparedness for terrorism was placed in the Border and Transportation Security Directorate, while other preparedness efforts are located in the Emergency Preparedness and Response Directorate. This bifurcation creates additional challenges related to inter-departmental coordination, performance accountability, and fiscal accountability. On September 2, however, DHS Secretary Ridge announced that soon he will be sending to Congress a plan centralizing these programs within a single office.

Additionally, DHS absorbed about $2.8 billion in disaster assistance grant programs from FEMA. FEMA's OIG found that it had ineffective performance and financial oversight for these grants, which in turn enabled grant recipients and subgrantees to misuse millions of dollars in federal funds. Grant recipients' problems with financial management, procurement, and sub grant monitoring are long standing. Between 1993 and 2000, for example, auditors questioned the use of funds totaling nearly $900 million dollars. An assessment of mitigation grants awarded between 1989 and 1998 disclosed that half of the $2.6 billion in grant awards was never spent.

FEMA's OIG found recurring grant management problems at the state level, too. Often states did not monitor or accurately report on sub grant financial and performance activities. They did not always make payments or close out projects in a timely manner. Their financial status reports to FEMA were often incorrect or past due. And, they did not always maintain adequate documentation supporting their share of disaster costs and other financial requirements. The OIG found that FEMA seldom used its enforcement power to compel grantees to fix problems, even when the grantees had long histories of noncompliance. Finally, the OIG cited FEMA's debris removal program for its susceptibility to serious fraud, waste, and abuse.

A sound grants management program to remedy these concerns must include:

- A comprehensive grants management system that complies with grant financial systems requirements issued by the Joint Financial Management Improvement Program. In addition, DHS must ensure compliance with the Federal Financial Assistance Management Improvement Act of 1999, which requires use of electronic application and reporting by grantees via the Internet.

- Effective monitoring of and assistance to states and other grantees in all phases of the grants management life cycle from award to closeout. Grant closeouts and required audits should be within established time periods, and extensions must be adequately justified, approved, and documented.

- Adequate training and supervision of the grants management workforce.

- Meaningful performance goals and measures of effectiveness.

Contract Management

DHS also absorbed billions of dollars in contracts from the component agencies that were awarded under differing procedures and circumstances. DHS must integrate the procurement functions of several legacy agencies, some lacking important management controls. The General Accounting Office (GAO), for example, reported that Customs had not established process controls for determining whether acquired software products and services satisfied contract requirements before acceptance, nor established related controls for effective and efficient transfer of acquired software products to the support organization responsible for software maintenance. At TSA, where contracts totaled $8.5 billion at the end of calendar year 2002, the Department of Transportation OIG found that procurements were made in an environment where there was no pre-existing infrastructure for overseeing contracts. TSA had to rely extensively on contractors to support its mission, leading to tremendous growth in contract costs. A review by TSA of one subcontractor involved with hiring airport screeners found that, out of $18 million in expenses, between $6 million and $9 million appeared to be attributed to wasteful and abusive spending practices. Our office is currently reviewing several of the TSA contracts including a detailed audit of the screener contract, in conjunction with the Defense Contract Audit Agency.

Also, some DHS components have large, complex, high-cost procurement programs under way that need to be closely managed. For example, Customs' Automated Commercial Environment project will cost $5 billion, and Coast Guard's Deepwater Capability Replacement Project will cost $17 billion and take more than twenty years to complete. Further, some contracts, regardless of their earlier merits, may need to be revised or may no longer be necessary to accomplish DHS's mission.

Early attention to strong systems and controls for acquisition and related business processes will be critical both to ensuring success and maintaining integrity and accountability. Steps would include:

- Establishing an overall acquisition strategy for modernization of legacy program and financial systems.

- Reviewing all contracts transferring to DHS to ensure they are relevant to the agency's mission and - particularly for systems development contracts - will not be affected by, or conflict with, DHS system integration efforts.

- Ensuring that contracting officers and their representatives are properly warranted, trained, and supervised, and that they maintain proper documentation in contract files.

- Establishing a robust and effective contract management and oversight function.

- Establishing effective systems and controls for managing purchase and travel cards.

Improper Payments

The Improper Payments Information Act of 2002 requires agencies to review all programs and activities they administer annually and identify those that may be susceptible to significant erroneous payments. Where the risk of erroneous payments is significant, agencies are to estimate the annual amount of erroneous payments and report the estimates to the President and Congress with a progress report on actions to reduce erroneous payments.

Since DHS must comply with this Act in FY 2004, we will be performing limited procedures during the FY 2003 financial statement audit to assess the agency's readiness to meet the reporting requirement.

Performance Reporting

Appropriate plans (including workforce plans), goals, objectives and meaningful performance measures must be established as soon as possible, and is a challenge for any agency. DHS has implemented a comprehensive Measures of Effectiveness project under which such measures will be established through a top-down process based on the DHS strategic goals. We commend the agency for this effort.

COMMENTS AND SUGGESTED REVISIONS TO H.R. 2886

Financial Statement Waiver

H.R. 2886 waives the requirement for a financial statement audit of DHS until FY 2004. However, completion of a FY 2003 financial statement audit for DHS is important for several reasons. Effective in FY 2004, OMB accelerated the reporting deadlines for Performance and Accountability reports, including audited financial statements, to November 15, 2004. It is unlikely that our office could complete its FY 2004 audit of DHS' financial statements by that date, without at least one year's prior experience, given the short history of DHS and the scale and complexity of its programs and operations. Further, the lack of an audit this year and possible audit timing problems next year could negatively affect GAO's government-wide financial statement audit by increasing the risk of DHS receiving a disclaimer or a qualified opinion.

We believe emphatically that financial accountability for DHS should not be postponed. Its newness, size, and complexity strongly argue for more oversight, not less. GAO has designated the establishment and operation of DHS as a "high-risk" area. An audit of DHS' financial statements is a key oversight mechanism. Not only do audited financial statements provide insight into the reliability of financial reporting, the audit report itself provides details on internal control weaknesses and non-compliance that put financial reporting and safekeeping of assets at risk. We strongly believe that this information should be reported sooner rather than later so that no time is lost in charting and implementing corrective actions.

The CFO of DHS is working diligently to have auditable financial statements for FY 2003 by November 15. Our audit is well underway and we plan to complete the audit by January 31, 2004.

Opinion on Internal Controls over Financial Reporting

With respect to the proposed requirement for an opinion on DHS' internal controls over financial reporting in FY 2004, the OIG believes such a requirement would be beneficial in concept, but it is not practical to perform an audit of internal controls at this time for several reasons.

First, fundamental to rendering an opinion on internal control, under attestation standards currently proposed by the American Institute of Certified Public Accountants (AICPA), is "management's assertion" on controls over financial reporting. Management must provide the auditor an assertion that significant controls over financial reporting exist and are designed and operating effectively during the period under review. In order for management to reasonably make this assertion, it must make an assessment of those controls including an evaluation of control effectiveness using suitable criteria, such as the GAO's *Standards for Internal Control in the Federal Government*, and support the evaluation with sufficient evidence such as testing.

Management's assessment of internal controls under the AICPA guidelines would be an extensive, time consuming process requiring sufficient lead time to institute. The need for management to first assess and test controls contributed to a one year deferral of the requirement for publicly held companies to have an independent audit of internal control, pursuant to the Sarbanes-Oxley Act of 2002.

Second, DHS's situation is significantly more complex, with its inception occurring this year, compared to that of a publicly held company that has established processes, financial systems, and the general infrastructure to support the extensive effort required before an audit of internal controls can be performed.

Third, with the advent of Sarbanes-Oxley, changes are occurring in the auditing profession. Although Sarbanes-Oxley applies only to public companies, it could have an impact on auditing standards for other entities too, including government agencies. The Auditing Standards Board (ASB) of the AICPA in June 2003 submitted to the new Public Company Accounting Oversight Board (PCOAB)[2] its recommended new, significantly expanded attestation standard for reporting on internal control over financial reporting. In the submission letter, the AICPA said it believed the proposed standard should apply to all engagements and not just to public companies.

It should be noted that the intent behind the requirement to opine on internal controls over financial reporting is similar to the intent behind FMFIA, although FMFIA has involved a far less rigorous process. Consideration should be given to combining these requirements when deliberating the proposed internal control reporting requirements.

Even without an opinion on internal controls, our financial statement audit report will identify material weaknesses and other reportable conditions related to financial reporting. For example, DHS financial statement auditors for FY 2003 will consider internal controls related to financial reporting for grants, procurement, property and equipment, inventory, budgetary reporting, liabilities, and many other categories.

We believe there would be significant additional cost to render an opinion on internal controls. The size of this increment would depend on the extent of evaluation and testing performed by DHS and the audit approach for the financial statements. In the private sector, one survey found that the cost of complying with the internal control reporting requirements of Sarbanes-Oxley would increase the average audit cost by 35 percent. This might be on the low-end for DHS because of its newness and complexity. Further, there will likely be significant costs associated with management's assessment of internal controls, which, as explained above, would be a prerequisite for the audit.

We believe that rendering opinions on internal controls over financial reporting at agencies could be beneficial by identifying additional weaknesses, and focusing attention on the state of financial management in the government. The terminology of a clean opinion versus a qualified opinion or disclaimer provides a ranking system that is easy to

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[2] The PCOAB has jurisdiction over auditing standards for public companies covered by Sarbanes-Oxley.

grasp. The downside is the additional cost to fund agency preparations and the audit itself.

CONCLUSION

Mr. Chairman, this concludes my prepared statement. I have tried to limit my remarks to the areas of greatest concern and your specific questions. Please be assured that our office will continue to place a high priority on these issues. Again, I appreciate your time and attention and welcome any questions you or members of the Subcommittee might have.

Appendix

To the Statement of J. Richard Berman
Assistant Inspector General for Audits
U.S. Department of Homeland Security

Summary of Material Weaknesses
Related to FY 2002 Financial Statement Audits

Federal Emergency Management Agency

1. Information security controls for FEMA's financial systems environment need improvement.

   Deficiencies existed in the areas of security program planning, training and awareness, background investigations, system certification and accreditation, technical vulnerabilities, terminations, service providers, and wireless communications.

2. FEMA's financial system functionality needs significant improvement.

   Functionality deficiencies included: (1) inadequate accounting functionality in the property management system, (2) inefficient payroll processing, (3) no managerial cost accounting system, (4) interface problems with the HHS' funds disbursement system, and (5) inaccurate vendor table data leading to inefficiencies.

3. FEMA must improve its financial reporting process.

   Deficiencies in FEMA's financial reporting process included: (1) significant delays in preparing financial statements, (2) unfinalized standard operating procedures for statement preparation, (3) lack of an integrated financial reporting process, (4) untimely close-outs for interagency agreements, (5) notable adjustments related to de-obligations, expense accruals, and the recording of disbursements as advances, and (6) inconsistent treatment of three unusual contingent appropriations.

4. FEMA must improve its real and personal property system processes.

   FEMA lacked a property management system that met its accounting needs. The system only tracked equipment, not other types of property. The system changed acquisition dates for equipment upon transfer and did not link the location of equipment to the accounting records. FEMA did not have procedures to ensure proper property inventories or to ensure the consistent recording of equipment on

either a system or component basis. Processes to identify, value, and track construction in progress and deferred maintenance were not fully implemented.

5. FEMA must improve its account reconciliation processes.

   Reconciliation deficiencies were noted in the areas of accounts payable, unliquidated obligations, fund balance with Treasury, the suspense fund, reimbursable activity, and intragovernmental balances. Deficiencies were related to timeliness, procedures, documentation, or consistency.

6. FEMA must improve its accounts receivable processes.

   FEMA needed to improve its billing timeliness for certain accounts, although it had made progress during the year.

Immigration and Naturalization Service

1. INS' information system controls need improvement.

   Deficiencies existed in the areas of access controls, audit trails, back-up procedures, change controls, and system software controls.

2. INS' existing systems are not adequate to record revenue transactions in accordance with federal standards.

   The INS did not have a reliable system that could provide regular, timely data on the number and value of immigration applications and petitions received, completed, and pending. This information was necessary to support general ledger entries required for recording fee revenues that were earned when the related applications were completed. Instead, the INS recorded earned revenue in its general ledger when the fees were received.

3. INS' processes for financial accounting and reporting need improvement.

   Due to limitations in the design and operation of its legacy financial accounting system, INS did not maintain integrated perpetual general ledger records for many key accrual balances. Instead, the INS used stand-alone systems and performed limited general ledger updates, or it obtained the required balances through manual processes and data calls and recorded "on-top" adjustments as part of the financial statement preparation process. Additionally, the INS did not perform monthly, or at a minimum, quarterly reconciliations of certain major account balances.

Transportation Security Administration

1. Hiring qualified personnel

   TSA had not hired sufficient accounting personnel for the Financial Reporting office. At the end of fieldwork, the vacancy rate in the CFO's financial management structure was 50 percent.

2. Financial reporting and systems

   Personnel separations from TSA were not processed on a timely basis in the personnel system. Other deficiencies existed in the areas of access controls, security plans, and risk assessments.

3. Property accounting and financial reporting

   TSA did not maintain complete and accurate records of its passenger and baggage screening equipment, and an adjustment of approximately $149 million was required to properly record construction in progress.

4. Policies and procedures

   TSA did not have written accounting policies and procedures to support TSA's financial management and budgeting functions. Such policies and procedures might have prevented the following deficiencies:

   a. An adjustment of approximately $1.0 billion to accrue accounts payable properly for year-end.
   b. An approximate backlog of $322 million in purchase orders/obligating documents that were not entered into the accounting system at year-end, often because of incomplete and erroneous accounting information.
   c. Adjustments of $309 million and $101 million to correct for improper expensing of equipment meeting TSA's capitalization criteria.
   d. Untimely recording of accounts receivable for air carrier and passenger security fees.
   e. Lack of a process to develop appropriate disclosure information related to leasing arrangements when initially drafting financial statements.
   f. An adjustment of approximately $45 million to correct the expensing of a grant advance payment.

   TSA also did not have a process in place to monitor and evaluate its accounting and internal control systems to meet FMFIA reporting requirements.

5. Administration of screener contracts

   TSA did not have policies and procedures to provide an effective span of control to monitor contractor costs and performance. Contractors did not always provide evidence to support rates or specific cost and pricing data, nor did they always definitize their contracts, as required. These deficiencies left TSA vulnerable to inflated labor rates and other inappropriate charges.

United States Customs Service

1. Customs did not adequately monitor the effectiveness of its internal controls over the entry duties and taxes in 2002.

   After the events of September 11, 2001, Customs suspended its Compliance Management program. This program evaluated Customs' risk-based approach to trade compliance by assessing whether revenue collections reasonably approximated those actually due. Without the CM program, Customs lacked an important internal control related to revenue collection during FY 2002.

2. Drawback controls need to be strengthened.

   Customs' Automated Commercial System (ACS) could not perform certain processes that would have facilitated monitoring of the drawback program. To monitor the program, Customs used a risk management process to select claims for review. Although the process was supposed to allow for statistical projection of the results, personnel were allowed to reduce the random sample to a baseline number, thus impeding the statistical projection of results. Reconciliation procedures for related drawback claims also were not sufficiently comprehensive.

3. Customs IT system logical access and software maintenance security controls need improvement.

   Deficiencies existed in the areas of network and host-based system configuration, password management practices, logical access controls, application programs, computer-related facilities and equipment, and software patches. These weaknesses put Customs at risk of unauthorized system access, modification, disclosure, loss, or impairment.

4. Core financial systems need to be improved and integrated.

   Customs' core financial systems did not provide certain financial information necessary for managing operations. Also, they did not capture all transactions as they occurred during the year, did not record all transactions properly, and were not fully integrated. Additionally, the systems did not always provide for

essential controls with respect to override capabilities. As a result, extensive manual procedures and analyses were required to process certain routine transactions and prepare year-end financial statements.

Mr. PLATTS. Thank you, Mr. Berman.

I would like to recognize the gentleman from Ohio, Mr. Turner. I appreciate your joining us here today.

We will get right into questions and I will throw out kind of a broad opening question for all our witnesses. Before I do that, I do want to convey my thanks, Mr. Williams and Ms. Springer have heard me say this before, but to Mr. Carnes and Mr. Berman, I want to personally thank you for your public service. As one who believes in the idea of public service, whether elected officials or others in government, I think it is important to recognize your service to your fellow citizens. I appreciate your work. While we may have some differences of opinion on the legislation, that in no way diminishes my gratitude for your work.

My initial question is the issue of the broad inclusion of DHS in the CFO Act. When the legislation began last session and this subcommittee under Chairman Horn was involved as it went through the House and passed. DHS was under the CFO Act and the House took an active role in putting it in there, led by Chairman Horn. Its removal occurred in a less public, less active way in conference and came back in a very complete package, so there wasn't the same active decision by Members of the House on this specific issue as in taking it out.

I would be interested in any of your opinions and your understanding of why it was not included, why it was taken out in the final decision and final conference report that came back to the House and Senate?

Mr. CARNES. I don't have any information on that. I don't know how that happened or the circumstances under which it occurred, but if you permit, I would make these comments. DHS is complying with the provisions of the CFO Act anyway. Even if we wanted not to, we couldn't get away with it because these guys would make it impossible for us to do so. So we do adhere to the provisions of the CFO Act with respect to accountability, integrity and the like and are meeting all those requirements as well as the requirements that OMB places on us for financial statements. I think in that sense, I would say we are certainly adhering to those provisions.

I think Ms. Springer said earlier that the administration's position is we would not object to having those codified but that is where we are right now.

Mr. PLATTS. I do want to explore that further in the sense of what you are doing and what you have to legally do and that relates to long term structure and statutory requirements.

Do any of the other three want to conjecture a thought as to the decision? If not, that is fine but I wanted to give you that opportunity.

Ms. SPRINGER. I will just comment for the record that I was not a part of that and I guess the previous Deputy Director for Management at OMB would have been the most involved individual.

It is my understanding that the combination of all the management type functions under the Under Secretary was deemed to have value, the coordination under one head of the CIO, the procurement, the financial CFO functions. I wasn't a part obviously and no one asked for my input to that. I wasn't even confirmed at that point but I think the basic thrust was that the coordination

of those under one Under Secretary had some value. I don't understand the process of the timing but I think that was the thrust behind the structure.

Mr. PLATTS. Maybe we will kind of lead into the next question which was going to be on the administration's position. I understand you weren't involved in the initial structure being established but are in the position now dealing with that. Doesn't it seem somewhat inconsistent that DHS is the only Cabinet level agency that is not under the CFO Act and does not have a requirement for Senate confirmation of its CFO. I know DOD, Transportation and all the other departments have that requirement such as specific Senate confirmation. Do you acknowledge that inconsistency? Is it OK or is there another position of the administration?

Ms. SPRINGER. A couple of points. I believe the Department of Justice CFO may also not be subject to confirmation. I believe it was Public Law 106–113 subsequent to the CFO Act.

Mr. PLATTS. I would add that change was done in a similar fashion, one line in a very omnibus bill, not by the committee with oversight and not in a conscious light of day way.

Ms. SPRINGER. Those would be the two Cabinet agencies. I will tell you how I operate and how I view this as the Controller at OMB. I don't really make a distinction between the Cabinet agencies, they are listed separately in the CFO Act and subject to Senate confirmation and the other agencies like GSA, previously FEMA and some of the others listed, USAID, others listed separately and not subject to Senate confirmation where the agency head appoints the CFO. I have found that all of the CFOs, regardless of being subject or not to confirmation, have followed the spirit and the substance of the CFO Act. There has been no distinction in the performance and the standards to which they hold themselves. All these people have professional standards anyway as CPAs, professional designation or organization responsibility, as well as, as you said earlier, their stewardship responsibility as officials in Government. I have never seen any difference between those confirmed and those that are not in their practice, how they manage their organizations. And they have all held themselves to a very high standard.

The administration currently has been working with Congress to explore ways to reduce the number of Senate confirmed positions. I haven't been a part of that directly but I am aware of it and the CFO position is one that is currently being reconsidered for not being subject to confirmation across the board.

Mr. PLATTS. Would that be all CFOs and all Cabinet level agencies? My understanding is DOD may not be included in that.

Ms. SPRINGER. Someone brought that to my attention the other day. What I learned was there is a basic premise that all Deputy Secretaries and all Under Secretaries would be subject to Senate confirmation. It happens that the CFO at the Department of Defense is an Under Secretary position, so on that basis, they would be subject to confirmation but not for any other reason related to the substance of the CFO position.

Mr. PLATTS. Doesn't that get into the issue of consistency and why the DOD CFO is deemed necessary to be an Under Secretary reporting directly to the Secretary of Defense and DHS contends

one doesn't need to be at that level, can report to an Under Secretary, not have direct access as well, and not be Senate confirmed? So there is a substantive inconsistency between what the administration's position would be at DOD, CFO, high level, direct access, Senate confirmed; DHS, lower level, no direct access, no Senate confirmation. That is a significant inconsistency that doesn't seem yet to be explained by the administration or why they support that inconsistency.

Ms. SPRINGER. There are a couple issues you raise. We could certainly talk about the effectiveness, what value the reporting relationship has to the effectiveness of the CFO. I think you would find the reporting relationship is less a determinant than the qualifications and the expertise and the management capabilities of the CFO. Than whether or not they have one box in between or two boxes in between, or they are reporting to the Secretary.

I don't know why the DOD position is at the Under Secretary level. I can tell you that was the only reason why that one position was in this proposal. This list is still subject to confirmation. It is not a function of their duties. It was just the basic assumption that Under Secretary and Deputy would continue to be subject to confirmation.

Mr. PLATTS. On your comment that you don't think the direct reporting would have an impact, in the private sector you served in a Chief Financial Officer position?

Ms. SPRINGER. Yes.

Mr. PLATTS. It did not benefit you in your role as Chief Financial Officer to have direct access to a CEO as opposed to going through another layer of management before your feedback was able to be received by the CEO?

Ms. SPRINGER. I have had financial responsibilities where I have had one layer removed, two layers removed and so on and in any case, I felt my effectiveness was more directly a result of my own knowledge of the business, financial expertise and ability to lead that group. You find ways to be able to get to the CEO, one way or the other. My empowerment was really not a function of the reporting relationship candidly.

Mr. PLATTS. So your position is from your comfort level that your opinion and expertise on financial matters was not enhanced. You didn't have greater comfort knowing you spoke to the senior officer in charge of the company. It wasn't enhanced versus having to work your way or try to find a way around another level of management. It seems natural that you get to talk to the final decisionmaker who is going to act on what your work is and it is not edited, not changed in any fashion by somebody in between you and that other officer?

Ms. SPRINGER. That really got to the level of confidence I had in anyone who was in between me and the CEO. If I was confident that I was able to communicate through that person, I had no problem with it whatsoever.

Mr. PLATTS. That goes exactly to the issue here.

Ms. SPRINGER. My own personal effectiveness, I felt, honestly, Mr. Chairman, was my ability to be effective, to get change, to get results, and was really less a function of that than being able to

win the confidence based on my knowledge and ability of the position.

Mr. PLATTS. Your comment goes exactly to the issue here. In 1990, the Congress put in place by statute structurally in place that we didn't have to depend on what persons were in these offices to ensure there was good feedback, ensure the qualifications of those people in the CFO positions and direct access to the Secretary, the chief officer of whatever agency it was. It wasn't dependent on who was in between; it was guaranteed. In other words, it is permanent statutory structure as opposed to what now is a decision of this administration to comply with the CFO. There is no guarantee that the next administration will choose to do that. They could say, we don't like the CFO Act, we are not required to follow it, so we're not going to.

Currently, CFOs reporting to an Under Secretary, we could have great confidence in that Under Secretary that what you pass on truly gets to the Secretary. That may not be the case in this administration with whoever the next Under Secretary is or perhaps the next administration. That is what we think is the shortcoming in the way DHS was established, that it is not ensuring in a structural sense the best scenarios versus relying on personality only.

Ms. SPRINGER. I understand your issue. Obviously as the Controller, I am concerned that a financial management issue has the highest level of attention. I will tell you I don't think a direct reporting relationship to a Secretary is necessarily a guarantee that it will get any more attention than it would if you had a strong Under Secretary that is working with you and can devote time. Clearly in an agency like Homeland Security, the Secretary has many things to do and I would think it might be helpful to have someone else working with you.

I understand your point and I think it can work.

Mr. PLATTS. I am going to let other Members jump in here but on the same line, with the Senate confirmation and your own qualifications are great, were well reviewed and considered a part of your own confirmation process. The CFO Act requires your position to be Senate confirmed. Would you agree that going through a Senate confirmation, you or anyone, adds additional scrutiny, additional accountability to one's qualifications to make sure somebody doesn't slip through who has fabricated diplomas, fabricated their education, their background, their work experience, that Senate confirmation adds additional scrutiny to that selection who is given some tremendous fiduciary responsibilities? Would you agree that the confirmation process adds that scrutiny, that additional accountability?

Ms. SPRINGER. I would agree that the people involved in the confirmation process of the appropriate Senate committee provides another set of eyes in individuals reviewing the credentials. I would also say that prior to getting to that point, I was subject to a great deal of scrutiny on behalf of the people evaluating me before it even got to the point of the Senate. I don't think it would have gotten to that point of recommendation to the Senate unless I had cleared just as high a hurdle. I think the hurdles were very high getting to that point. So clearly it is another set of eyes but it didn't raise the bar any in my judgment.

Mr. PLATTS. I may stand corrected but my understanding is under the current Under Secretary for Management in DHS, one of the other senior personnel that is not Senate confirmed has some issues that came to light late in the process regarding the accuracy of qualifications submitted that were not caught by the administration's vetting of that person for a senior management position. If there were Senate confirmation, more likely maybe it would have.

Ms. SPRINGER. I am not familiar with that.

Mr. PLATTS. I don't want to go into detail because of making sure I have my facts right but to move away from Senate confirmation, to additional accountability. When the President's management agenda is emphasizing more accountability, especially in the area of financial management and it seems like we are saying one thing and in action, saying we really want less accountability in who we choose to put in these positions. From the administration's position, that seems pretty inconsistent to me.

I don't want you to think I am just picking on you because I do have a lot of questions but I want to let the ranking member have an opportunity and Mr. Turner and others who may be here later. I will now recognize the gentleman from New York, Mr. Towns.

Mr. TOWNS. Thank you, Mr. Chairman.

Let me also associate myself with the remarks made in commending our witnesses on their years of public service. I would like to join in that comment.

Let me begin with you, Mr. Williams. You testified about inadequate controls over security screener contracts at the Transportation Security Agency. Apparently inadequate monitoring of contracts allowed contractors to charge 97 percent more than the contractors charged air carriers prior to Federalization. That seems outrageous. Do you know how much money was lost through this overcharging and whether the department has made an attempt to recover these funds?

[The prepared statement of Hon. Edolphus Towns follows:]

Statement of Congressman Ed Towns
Subcommittee on Government Efficiency and Financial Management

Hearing: "Developing Sound Business Practices at the Department of Homeland Security"

September 10, 2003

Thank you Mr. Chairman, and welcome to our witnesses.

The creation of the Department of Homeland Security is the largest reorganization of the federal government since the creation of the Department of Defense in 1947. This new cabinet-level Department combined 22 different agencies with a wide variety of missions – everything from law enforcement and border security to biological research, computer security, and disaster mitigation. It includes an estimated 170,000 employees.

This is a mammoth undertaking, made all the more important by the Department's primary mission of protecting the American people from terrorist attack.

Meeting the goals of ensuring financial accountability and preventing waste, fraud, and abuse at the Department of Homeland security requires first and foremost leadership dedicated to establishing effective financial management. On that issue, I was pleased to learn that the Department plans to prepare and audit financial statements in its very first fiscal year – 2003.

In addition to successfully merging the financial systems of its 22 constituent agencies, the Department must also insist on strong adherence to financial principals by those agencies, many of which have had problems with financial management in the past. The Federal Emergency Management Agency, the Immigration and Naturalization Service, the Transportation Security Agency, and the Customs Service have been identified by GAO and the Department's Inspector General as needing particular attention.

I also want to commend Chairman Platts for introducing H.R. 2886, the "Department of Homeland Security Financial Accountability Act." I was pleased to cosponsor this legislation along with Chairman Tom Davis, and Representatives Waxman and Blackburn. The principle effect of this bill would be to bring the Department under the Chief Financial Officers Act of 1990, and thereby treat the Chief Financial

Officer of the Department the same as every other cabinet-level CFO in the executive branch. This was not done in the legislation creating the Department and H.R. 2886 will correct that unfortunate oversight.

As we approach the two-year anniversary of 9/11, it goes without saying how critical it is for New York City and the entire nation to have a Department of Homeland Security that operates effectively and is accountable. I look forward to hearing from today's witnesses about how this legislation will help us accomplish that objective.

Thank you Mr. Chairman.

Mr. WILLIAMS. I do not have a number as to how much money was actually lost or if there was any money actually lost. In the audit process, we were basically looking at the procedures for the purpose of deciding whether we could rely on various controls, so I do not have a specific number. We can followup to see in the followup work if there was a number determined but I do not have one at this particular time.

Mr. TOWNS. But it looks like money was lost, doesn't it?

Mr. WILLIAMS. We will followup and see. In a control environment like that, you have the risk of money being lost but whether it is lost or whether it is inefficiencies, we will take a look and provide an answer for the record.

Mr. CARNES. Mr. Towns, could I add something?

Mr. TOWNS. Sure.

Mr. CARNES. That contract was entered into before DHS was created. That contractual relationship has been severed and the Department of Homeland Security will be seeking to recover funds.

Mr. TOWNS. So money was lost?

Mr. CARNES. Lost but we know where it is.

Mr. TOWNS. We don't want to use stolen, do we?

Mr. CARNES. No, we don't want to characterize it in any way except we believe we paid more than we should have for that contract and we are seeking to recover those funds.

Mr. BERMAN. One more clarification on that. The IG's office now has an extensive audit underway on that contract in conjunction with the Defense Contract Audit Agency. The work is still underway but when the work is completed, the costs that are questioned, including costs that have not been properly documented or costs that at least appear to be excessive, will be resolved by the contracting officer. It is a complicated contract and we can certainly endorse the previous findings of the Department of Transportation IG that proper oversight of this contract was not maintained at TSA.

Mr. TOWNS. Thank you. I appreciate your shedding some light on it.

Mr. Williams, you testified that the INS collected $1 billion in fees from immigration applications in fiscal year 2002 but lacked a reliable system to track those applications and fees. The INS therefore had to rely on a servicewide physical count of over 5.4 million applications which reportedly resulted in a 2-week hiatus in accepting new applications while forms were counted. Has this situation been corrected?

Mr. WILLIAMS. As of the last audit report, it had not been corrected. This is a process in which the agency is basically trying to determine what a specific number is. They are trying to distinguish the money that was collected that the agency can actually say was earned and money it has collected and has not earned at a particular point in time. As of the last audit report which is what we reflected in my testimony, the problem had not been corrected. The current audit should reveal whether the agency has made progress in this particular area.

Mr. TOWNS. Mr. Carnes, can you provide any insight on this issue?

Mr. CARNES. Yes. First of all, it is a complicated issue as Mr. Williams was saying because it has to do with the accrual of revenue over multiple years after a person has provided his fee for immigration review. That revenue is actually booked and earned over a period of years. So it is very complicated.

INS has agreed with all of the findings of the audit and has developed a corrective action plan. During fiscal year 2004, they will roll out the functionality to support deferred revenue and then hope to have the entire project wrapped up by 2006. It is a complicated, difficult systems problem and it is going to take a long time and a lot of money to fix it but they do have a plan and they are on track with that plan.

Mr. TOWNS. I guess provision is being made to seek the money?

Mr. CARNES. Yes. We have a major systems initiative which we are kicking off which will solve many of these problems.

Mr. TOWNS. Mr. Berman, let me ask you this. The problems are similar to those in grants management. The department's procurement operation inherited numerous systems, some of which lack important controls. Does the department have an action plan to reach a contract management system that will ensure effective and efficient use of tax dollars?

Mr. BERMAN. The department is still building its systems and until recently, the CFO was also the acting chief procurement officer. It now has a procurement officer in place. It has established review procedures not only to cover new contracts, but to go back and assess, as we suggested, the contracts they have inherited to make sure those contracts are consistent with Homeland Security's objectives and consistent with other contracts in the same area. However, there is a long way to go and in our audits of individual contracts, we continue to find major problems that were inherited from the component agencies and need to be dealt with.

Mr. TOWNS. Mr. Carnes, do you have any comments on that?

Mr. CARNES. Yes. One of the things Mr. Berman is talking about is an Investment Review Board process which is essentially a process modified from a DOD model. DOD knows how to make contracts and they know how to manage contracts. They are very good at it, the best in government when it comes to managing projects and managing contracts. We are borrowing their practices wherever we can and creating an Investment Review Board to review all of these contracts before they are let is an important first step and then reviewing them periodically throughout their execution to make sure they are on track.

Second, we are doing a Joint Requirements Council which makes sure if this guy is buying airplanes and that guy is buying airplanes, seeing if we can buy one airplane to satisfy both requirements rather than multiple airplanes.

We are also requiring that we have certified project managers on top of our projects so they are managing the projects according to the proper procedures such as earned value management systems.

Yes, I think there is a weakness in our contracting performance. I think the expertise varies across the department but we are taking the best where we can find it and we are going to build to the best there is.

Mr. TOWNS. Will we have another opportunity to ask more?

Mr. PLATTS. Yes.

Mr. TOWNS. Thank you. I yield.

Mr. PLATTS. Mr. Turner, do you have questions?

Mr. TURNER. Thank you, Mr. Chairman.

I certainly appreciate the chairman's efforts here to make certain we have as much information as possible as we look at the important issue of homeland security.

Mr. Carnes, in looking at your testimony, I am intrigued by your statement right before your closing. I served as a mayor of an organization that had 3,000 employees, a half a billion dollar a year budget. I always wanted as much information as possible because the more information and the more eyes we have looking at something, the more we had an ability to make the correct decisions about what would be best either cost effectively or to serve our community or public.

In your statement, you object to the fact that Section 3 includes a requirement that an audit opinion of the department's internal controls over its financial reporting. This is what intrigues me. You say, "An audit of internal controls would be costly and place excess demands on limited staff." We can all have separate opinions on what is costly and what would be a return but the next sentence is what troubles me. It says, "We believe that audits of internal controls should be reserved for special and unique situations where waste, fraud and abuse or misstatements are identified in the course of other audits or internal reviews, inspections or evaluations."

Don't you believe that audits of internal controls might find circumstances of waste, fraud and abuse where the other levels of audits or reviews might not?

Mr. CARNES. Possibly.

Mr. TURNER. How can you go to the next step of saying that you think it is not cost effective? Do you have a quantification of what level of fraud and waste you are willing to accept that you won't find?

Mr. CARNES. No, actually, I don't. You can make an argument that you cannot accept any and that you would spare no expense at all to avoid having $1 being misspent. Right now on our audit, we are spending almost $11 million. That is a lot of money for a financial audit. It is worth it. We believe that. The audits in the past of the components that have come into Homeland Security have identified numerous internal control weaknesses. In fact, I would say most of the serious problems that have been found before are internal controls related issues. I take them very seriously.

The estimate that Mr. Berman gave for the cost of another internal control opinion would be another third on top of that. I still think that is a lot of money. I am not opposed to internal control audits. At the same time, I have to figure out how to get a foot into a tiny shoe. I have to manage the budget of the department and try to get best value for the resources.

I know that our friends in GAO as well as the IG constantly advise us of problems they see in internal controls. We have over 200 and some ongoing GAO audits right now, reviews and studies and where we find these problems, we directly attack them. They are very important to us.

In addition, in my own office, I have an internal review function which I use as sort of my own IG, if you will, in-house, so that we can detect these things ourselves. My only issue here is principally a question of let us be sure we have a good basis upon which to require the audit and that it is resourced.

Mr. TURNER. Let us pause for a second because you admitted in your testimony that an audit of internal controls would likely identify waste, fraud and abuse that other types of audits or internal reviews do not. We know that the Department of Homeland Security is the largest government reorganization in 50 years, so you are not just an organization that has been operating, you are in process of pulling together many different organizations. An audit of internal controls is reviewing the processes by which that is done.

It would seem to me that specifically in the Department of Homeland Security that your margin of error, the process of running while at the same time you are organizing, would lend itself to greater difficulty in managing the organization and any additional information you have, you would want and not be opposed to.

Mr. CARNES. I am never opposed to more information. I am not suggesting in my testimony that I would be opposed to additional information. I am suggesting only a kind of cost benefit calculus.

I would also note that so far as I can tell, we would be the only department in the government that would be subject to this requirement. That seems to me to be somewhat anomalous. In addition, as I said before you came in, our friends at OMB have suggested what we ought to do is do a cost benefit analysis and see what the likelihood is of the return on such audits and see where we go from there.

Mr. TURNER. To switch the issues for a moment, the issue of Senate review, one of the issues that was discussed was the process of that review that would result in a review of qualifications. I would like everyone to talk about the issue of independence. It seems to me with such a process, it might provide greater independence. We know there are issues at the Department of Homeland Security that would require some pretty aggressive effort to make certain we meet the threats we have in front of us but also the performance we need to address those threats.

We just had a hearing this week in the National Security Subcommittee about the lack of an overall threat assessment for first responders so that we can have some national standards for what types of equipment, either technology or protective equipment and that appears to be something that needs to be ongoing.

You referenced issues of information technology. We have issues where as you look to the systems you have, what would be the most efficient and effective as you transform your systems that indirectly are financial in their implications, the area of independence and going through the confirmation process. Mr. Berman.

Mr. BERMAN. Our office is very supportive of the confirmation process for the exposure that it affords to an open discussion of the major management challenges, financial management challenges, and the possible solutions to those problems. Again, the confirmation process itself is certainly a valuable process.

To the extent that a person is chosen to be CFO, or any other position, it offers them the chance to present their own feelings and plans to address these issues. It is important to be able to track those statements and promises as they continue in the position.

Mr. CARNES. I have unfettered access to the Secretary if I need to get to him. I don't feel any infringement upon my independence or my ability to speak my mind. I will say that in development of our 2005 budget submission to OMB, we spent an incredible amount of time with the Secretary, over 4 days. I have never spent that much time with a Cabinet officer in any of my previous positions as CFO as I did with Secretary Ridge in carefully and elaborately and in detail going through all the budget. So I did not feel in any way restricted in my access or in my ability to communicate. I spoke my mind very frankly to him.

Mr. WILLIAMS. Mr. Turner, I would like to touch base on a couple points because I think they are linked and one goes back to the chairman's point about whether the agency should be included under the CFO Act.

I was involved in the original development of the CFO Act and in the late 1980's and leading into 1990 when the act was passed, the concern was that while we might have individuals in the current administration who are very supportive of financial statement audits, etc., there is no guarantee if you don't put this in statute that 10 years down the road you are going to still have this structure in place, that you are still going to have this commitment.

Also, during that time, I think Congress was able to see that the Chief Financial Officer should be a major player, a key player in the senior management of a Federal organization. Having that information, one of the things we noticed during that timeframe was that the CFO in a lot of instances was not at the table with senior management when a lot of decisions were being made. The CFO had a lot of responsibility outside of financial management and for the financial management that the CFO was involved in a lot of instances, that focus was primarily on the budget. There was not a lot of emphasis on the accounting and putting together financial statements for audits.

Having said all that, one of the key factors in looking at the CFO as far as independence and confirmation, I think going through the process would add some prestige, would give the CFO if properly placed in the organization a position at the table with senior management to be involved in the key decisionmaking that goes on at the various Federal agencies.

While this is one model and there are other models that could work, the key factors that you would have to look at are is this individual qualified, is this individual at the table when key decisions are made, is this individual listened to when he or she brings a point of view to the discussion.

Ms. SPRINGER. I would offer this additional comment to what I had said earlier. If Mr. Carnes had gone through the Senate confirmation process I went through, he would not be CFO at this date. There was a 7-month waiting period. All the things he has done would not have been done. So I am very happy, frankly, that Mr. Carnes didn't have to go through that.

Mr. TURNER. I was concerned there for a moment you thought there was a problem in his background. [Laughter.]

Ms. SPRINGER. I use myself as a current example. It was a very, very frustrating situation to have to wait for 7 months before I could be involved and actually productive. In an area like homeland security where there is such a criticality in being able to get some of these things addressed, it would have been a tremendous setback or loss for Mr. Carnes to not be engaged right from the very beginning. I just offer that for some perspective.

Mr. TURNER. Thank you, Mr. Chairman.

Mr. PLATTS. Because of Mr. Carnes' position at Energy, he was already a Senate confirmed appointee and would be in his position today because he already had that Senate confirmation.

More to the point, Ms. Springer, I agree the process in the Senate is flawed. The fact that 1 out of 100 can put a hold on somebody, that is not democracy at work; that a minority can stonewall and when our founding fathers established the filibuster process, they didn't mean you could go home and go to bed and filibuster while you were sleeping, they meant you stood on the floor of the Senate and filibustered to keep something from happening. I think the rules of the Senate need some dramatic reforms to ensure that the will of the people, the majority, carries the day and not the will of 1 over 99.

The problems of the Senate and the need for reform within the Senate I think doesn't argue, in my opinion, to the point that we should do away with other well intended, proven statutory requirements such as the CFO Act that has been in effect for over a decade.

Mr. Williams you went to the point that the current administration and the staff at DHS in particular, you are following CFO requirements even though you don't have to. We have someone of great caliber in the position of CFO. You have, as you said, unfettered access to the Secretary but that is today. The history of years and years and years of administrations, Republicans and Democrats, was that caliber of personnel and that focus on the issues you are focusing on, a testament to Secretary Ridge and the time he spent with you, was not the norm. That is why it was put in statute to say this will be the norm, not dependent on who is Secretary or who is the CFO. That gets to the very issue of why we think this needs to be done.

I have a lot of followup questions besides all the ones I wanted to get into and I am going to try to focus on them. Mr. Carnes, in your statement regarding the internal audit, I am going to come back to that issue but sticking first with the issue of the CFO's position and how he is regarded within the department and outside if he is not Senate confirmed, if he is not guaranteed direct access.

In talking about internal audits with Mr. Turner, you said your understanding was DHS would be the only department required to have audited internal controls and maybe that seems inconsistent, and why would we do it for DHS. Doesn't that translate to given at every Cabinet level agency, a CFO position is Senate confirmed and direct access is guaranteed and for that same reason, consistency while we should do the internal controls, based on your state-

ment, we should have CFOs be Senate confirmed or the DHS CFO be Senate confirmed and have direct access?

Mr. CARNES. I figured as soon as I said that, you would ask me that question.

Mr. PLATTS. It seems like a natural one to follow.

Mr. CARNES. Maybe the question is whether anybody in this position should be confirmed. I suppose that is the question on the table, whether these positions in fact rise to the level that requires Senate confirmation. I believe that is the issue really being addressed in the administration's position.

I guess I would say that I do my job the same way now that I did it when I was confirmed. There is no distinction. I do the same things, I have the same worries, I have the same concerns.

Mr. PLATTS. Your point about whether any CFO is of the level that should be Senate confirmed is a valid response but today that is the case. If the administration or the Senate decides to take 80 some positions and say these shouldn't be Senate confirmed, that would be the place then to say we have made the DHS CFO consistent with DOD, consistent with Transportation and all the other agencies, and now we are inconsistent and for all of them we are going to eliminate that problem. That is a debate that may or may not happen. Today, all the CFOs are required to be confirmed.

The other aspect if you do your jobs the same is your unfettered access. You talked about the 4 days specifically. Day in and day out, do you report directly to Secretary Ridge or to the Under Secretary?

Mr. CARNES. The Under Secretary.

Mr. PLATTS. When you were at the Department of Energy, did you report to an Under Secretary day in and day out or to the Secretary or Deputy Secretary?

Mr. CARNES. The Secretary and to the Deputy Secretary.

Mr. PLATTS. So that is different? So you are doing your job different today, day in and day out, you report to another level of management, not to the Secretary's office?

Mr. CARNES. That reporting chain is different.

Mr. PLATTS. But who you give advice to is not the ultimate decisionmaker, the Secretary, it is an Under Secretary. That is a significant difference.

Mr. CARNES. It varies. As I said before, depending on the issue, I can give plenty of advice to the Secretary.

Mr. PLATTS. Understood and as a proud Pennsylvanian who had the privilege of serving with the Secretary, then Governor, for 6 of my 8 years in the State House, you have a great Secretary and a true patriot leading your agency and meeting the challenges. I would expect he would tell anybody, the most senior deputy he has to the most junior staff person in the department, if you think I need to know something, I want to hear it because that is the type of person he was as Governor.

Mr. CARNES. That is how I read him now.

Mr. PLATTS. But day in and day out, your job is different. You are reporting and giving advice to an Under Secretary who you can't confirm for certain is passing on that advice as accurately as you would directly give it as when you were at Energy, correct?

Mr. CARNES. Correct.

Mr. PLATTS. That is a big difference. That is what this discussion is about. I think it is important we recognize that difference and not say I am doing things the same way. In reality, you are not.

Mr. CARNES. I do think that the Under Secretary represents my opinions very well with the Secretary when that comes up.

Mr. PLATTS. Under the Under Secretary, we have not just a CFO, we have a Human Capital Officer, we have a CIO. How much time each week do you think the Under Secretary spends on financial management issues?

Mr. CARNES. Fifty-percent of her time.

Mr. PLATTS. I am curious, how do you know it is 50 percent?

Mr. CARNES. Because we are always together, always either on the telephone or in her office or in my office.

Mr. PLATTS. Mr. Williams' testimony about the history of the CFO Act, he talked about the CFO and his involvement when it was passed and GAO's position. "At the time financial management was not a priority in most Federal agencies and was all too often an after thought. All too often the top financial management official wore many hats which left little time for financial management. He did not necessarily have any background in financial management and focused primarily on the budget. By establishing statutorily the position of CFO, requiring that the person in the position have strong qualifications, a proven track record in financial management and giving this person status as a Presidential appointee, the Congress sought to change the then existing paradigm."

Mr. CARNES. I am a Presidential appointee.

Mr. PLATTS. Presidential appointee, not Senate confirmed.

Mr. CARNES. Correct.

Mr. PLATTS. As the other Cabinet agencies are?

Mr. CARNES. Correct.

Mr. PLATTS. It goes to the history, the person you are reporting to that is ultimately reporting to the Secretary, even at 50 percent that is half her time versus all her time being focused on this issue. That goes to Mr. Williams' testimony of why Congress and the intent of Congress to say this would be a priority. This is how we spend tax dollars.

I want to get to some other issues and continue. One of the problems with not having Senate confirmation, I have seen on this committee and on other committees, is the administration would only allow Senate confirmed individuals to testify before congressional committees. If we do away with the Senate confirmation for the CFO and DHS, and ultimately perhaps with all these agencies, the person that will come to testify who is directly responsible for financial management will not be the person spending 100 percent of the time on the issue. That is my read on that. Is that a fair understanding?

If you are non-Senate confirmed CFO, you are not going to be allowed to come testify before this committee.

Ms. SPRINGER. I know there is a policy within OMB, nothing written, but certainly I am familiar with OMB's policy. We have only confirmed individuals come up to testify.

Mr. Carnes is here today. It would strike me there may not be any written governmentwide policy.

Mr. PLATTS. He was Senate confirmed, him specifically, at Energy before he moved over.

Ms. SPRINGER. Right, but not in his current capacity. I don't know that there is any governmentwide policy. There certainly is within OMB.

Mr. PLATTS. The practice in the sense of using this person that is not Senate confirmed maybe seems convenient. Maybe it is not a written formal policy but I have seen it used, that a person cannot testify if they are not Senate confirmed. This avoids that possibility that because of showing consistency across departments. That goes to the structure of what is required statutorily.

In trying to be fair to my other committee members, I don't want to dominate the whole time, so Mr. Towns do you have questions? I will yield to Mr. Towns.

Mr. TOWNS. I left the room so I am not sure what has been asked or what has been said.

Mr. Berman, your testimony includes an appendix that lists material weaknesses at four of the major constituent agencies of the department. Can you give us some details on the affected agencies at which problems are in most need of attention?

Mr. BERMAN. In general, I think probably one of the biggest single problems which threads through many of these agencies is the need for system functionality. A good example is the situation you highlighted at INS. The accounting aspects and the auditing aspects of that problem are really only the tip of the iceberg.

It exposes the fact that INS does not have a system to manage its work flow. It can't tell how many applications are in process at any given time or what their status is. It obviously has accounting implications as well. It is the kind of systems integration and functionality problem that is at the top of our list that needs to be addressed. Unfortunately, that is going to be a long term process. As the CFO testified, there are already actions underway to study the requirements for homeland security and to translate those needs into integrated systems, but that is going to take time.

There are a lot of other problems that are related to the individual business and accounting processes related to reconciliations, the accounting and tracking of payables and these sorts of issues that concern us and are necessary for efficient functioning of the financial operations.

Again, there is a lot of commonality among these kinds of problems, not just at these agencies but other agencies throughout government. Systems security is something that also is common across the board. We certainly have those problems ourselves. It is a major concern because of the interconnectivity of systems. We always address that as part of our financial statement audits. Even if financial systems, on their own, are sound the extent to which they are connected to networks that are subject to penetration by hackers and others presents a major concern that results in these weaknesses.

Those are some of the major concerns we have among those weaknesses.

Mr. TOWNS. Mr. Williams, I would like your comments on that as well.

Mr. WILLIAMS. I would agree with Mr. Berman's comments and would also like to add that I think this is an example that would demonstrate the intent that the CFO Act is working because when the act was drafted, there was a lot of discussion about opinions on financial statements. The ultimate goal or the intent of the act was not so much to get clean opinions on financial statements but to identify problems and weaknesses and to get agencies in a position where they had systems and procedures in place where they could produce timely, reliable and accurate information, not just 1 day out of the year but throughout the year on a day to day basis. I think this is a perfect example of where the CFO Act has done what it was intended to do.

Mr. TOWNS. Thank you.

Mr. Carnes, You testified you have directed various components of the department to create corrective action plans to address these 18 material weaknesses you inherited and that you are monitoring their progress closely. What is the current status?

Mr. CARNES. If you would like I can provide that. I have it with me here. It is several pages long. I would be happy to provide it for the record.

Mr. TOWNS. Mr. Berman, you testified about some of the problems the Department of Homeland Security faces with its $7 billion annual grants program. Integrating the various grant programs is one issue and inherited problems at FEMA seems to be another issue. You also mentioned a number of steps that the Department would need to accomplish to have an effective grants management program in place.

What is a reasonable timeframe to have an effective program in place? Has the department begun to address any of the issues you mentioned in your testimony?

Mr. BERMAN. There's two major groups of grants that the department has inherited, one group from FEMA and another major group from the Department of Justice, particularly the first responder grants from the Department of Justice. Those two groups operate under different systems currently.

One of the concerns that we raised early with the Secretary was in the case of the emergency preparedness grants inherited both from Justice and FEMA; they wound up in Homeland Security under two separate directorates. One thing we would like to see and that we encouraged was combining at least those grants under one organization.

The individual systems for administering grants may have been relatively sound except we found major weaknesses in the monitoring end of those operations. Most of the emphasis both in Justice and FEMA was placed on getting the funds out the door but the weaknesses occurred in terms of the lack of oversight over States and the States, in turn, over the individual recipients. A lot more work is necessary in that area.

The Justice Department systems, particularly the ones now being used to issue the first responder grants, is actually a very good step in terms of an automated system for operating the process. It involves use of the Internet and essentially complies with the requirements for e-grants—electronic award and control of those grants—which is a good first step. I think if that is successful, it

should help in expediting the use of that kind of system for both what is now in the EP&R Directorate and in the Border and Transportation Security directorate.

The Secretary, on September 2, announced his intention to submit a plan to Congress to combine the emergency preparedness grants throughout government into a single organization within Homeland Security. This is certainly something that GAO has recommended and with the appropriate systems to oversee those grants and manage those grants, it would be an effective way of assuring that duplication doesn't exist and there are appropriate criteria and measurement tools to assess the effectiveness of those grants. We endorse all those efforts.

Some of these efforts will take time. We certainly hope that even within DHS as much consolidation as possible would take place quickly and that a model system be adopted to be used for all these grants so that recipients are provided one set of forms, one set of requirements, and an effective set of monitoring tools.

Mr. TOWNS. Mr. Carnes, I would be interested in your comments too.

Mr. CARNES. I would like to say two things. First, the Secretary does intend to provide one-stop shopping for States and localities when it comes to emergency preparedness grants and he is very actively working to make that happen.

The second thing I would like to say is that I would be the last person to say there aren't serious concerns about some of the financial practices or systems that we have in DHS. Those problems are going to get fixed, in my opinion, as a consequence of a system enhancement initiative that I am launching now. That system initiative is as follows.

We are going to create a unified, integrated financial and business management suite of systems that brings together finance, accounting, budget, performance, human resources, contracting, all the business processes of the department will be integrated into one system or suite of systems.

The point here is we have to provide meaningful and significant information to the Congress and to our program managers. When I was a DFAS at one point in my tenure, we were trying to create lots of new systems that were CFO compliant. They were very expensive and we charged the military departments to do that.

It was my view that if you show me a CINC that cares about CFO compliance, I will show you a CINC who doesn't deserve his job. Their job is to fight war. My job as the CFO or as the Deputy Director at DFAS was to provide him the financial tools that he needed to do that. He needed to know right now what it cost to fly an F–16 for an hour. It was our job to provide that information. He needed to know how much money he had left. That is exactly the kind of information our folks need at DHS and that is the kind of information we are going to give them.

I brought over people who have great expertise in this from the Department of Defense to lead this initiative. We are going to reduce the number of financial systems that we have. We have 83 now. I don't know what the final number is. We have some that are probably OK, some that are pretty good. We are not going to throw those away, we will link those. We have some that don't

have functionality and are not good. We are going to shoot those in the head, we are not going to have those. We are going to integrate them, we are going to link them and it is going to provide information for our managers and for you and it is going to be CFO compliant if we do our job right.

Mr. TOWNS. Do you have any idea in terms of the cost in terms of the investment needed for this system to go into place?

Mr. CARNES. $150 to $200 million. That is my guess right now.

Mr. TOWNS. I yield back, Mr. Chairman.

Mr. PLATTS. Recognize the Vice Chairwoman of the committee, the gentlelady from Tennessee, Ms. Blackburn, for questions.

Ms. BLACKBURN. Thank you and thank you all for getting information to us on the front end. Some days we have votes and committees and other things that come up and we are not here in a timely manner. As Ms. Springer and Mr. Williams know, I love these hearings. I am glad to see Mr. Carnes and Mr. Berman.

I appreciate your openness and your willingness to provide us information, especially at a time like this when we have constituents every single day who want to know how we are spending their money because they are very concerned about how we are spending their money. They don't leave a lot of legal room for talk without action. They are demanding, as they should be because we have to remember every dollar that is spent is their money and it is coming out of their pockets.

Mr. Carnes, let us go back to this system initiative and your suite of systems you were discussing putting into place. As we have gone through a series of hearings this year and talked with different departments, I think it always concerns us when we hear these platitudes and these great plans but there is always a sticking point it seems.

You mentioned you think it will cost you $150-$200 million. How did you arrive at that estimate and on what did you base that estimate? Could you give us the different revenue streams and the different demands that are there?

Mr. Carnes. I might say as a general matter I try not to talk in platitudes, so I don't think I am leading you astray when I talk about what our objectives are.

What we have done is to bring on board individuals who have had many years experience in the development of systems at the highest level, finance and accounting systems as well as other systems.

Ms. BLACKBURN. Are you outsourcing that or are these individuals from inside government?

Mr. CARNES. Both.

Ms. BLACKBURN. And the number of individuals is 83?

Mr. CARNES. That is the number of systems that we have to lasso together.

Ms. BLACKBURN. So you brought the individuals from both inside and outside of government. How long have they been working on this to date?

Mr. CARNES. Four months.

Ms. BLACKBURN. What is your timetable for having this finished?

Mr. CARNES. It depends. I can do it in 2 years or I can do it in 5 years. It depends on cash-flow and financing the development. It

will cost less ultimately to do it quickly but each year's increment is big.

Ms. BLACKBURN. What system are you modeling this on?

Mr. CARNES. We haven't picked our system.

Ms. BLACKBURN. Who is developing your system infrastructure, your architecture?

Mr. CARNES. Catherine Santana, sitting right there.

Ms. BLACKBURN. Her background is what?

Mr. CARNES. She was developing the DOD system architecture.

Ms. BLACKBURN. The DOD system has not been completed, correct?

Mr. CARNES. Has not been completed.

Ms. BLACKBURN. It has been in process how many years?

Mr. CARNES. Many years and it is going to be many, many more years.

Ms. BLACKBURN. They have already spent how much on it?

Mr. CARNES. Lots. I don't have the number for you right now but it is a lot of money. I will tell you this though. DOD has made major progress, is getting clean opinions on various components of the Department of Defense, and systems have been rolled out and Ms. Santana has developed them and rolled them out that are JFMIP certified, that are CFO compliant, that are used throughout the entire Department of Defense and that are cheap to run and maintain, state-of-the-art.

Ms. BLACKBURN. I appreciate that but I think at the same time while you are looking at a suite of systems and need that for your management for your grants, for your contracting and I appreciate that, I would submit to you for consideration that possibly the fact that we are in need of funds for many different things within government, there is maybe not an ongoing willingness from the taxpayer to continue to see tax increases, they like to see those reductions and are looking for greater efficiencies, that such an answer and such an expectation may have a tendency to cause concerns from some of my constituents.

Mr. CARNES. Yes and actually I am not planning to ask the Congress for money.

Ms. BLACKBURN. You are going to do it out of existing revenue?

Mr. CARNES. I am going to do it out of the investments that are currently underway in the department on systems some of which need to be stopped, some of which need to be shrunk, and we will use those resources to finance this. We have an addition, they work in capital funds that has resources in it the purpose of which is to do major capital investments of this nature.

Ms. BLACKBURN. Mr. Carnes, have you all worked with Mr. Berman in identifying some processes and programs that could be terminated and funds redirected? mr. CARNES. I don't think I have gone to Mr. Berman with my recommendations yet and asked his view but I think he would agree with me in general. I haven't identified the specific ones but I think he certainly agrees with the principle.

Mr. BERMAN. I would agree.

Ms. BLACKBURN. Thank you all again so much for submitting your information.

Mr. Berman, you had submitted the addendum to 18 material weaknesses and your testimony referenced there may be more that would come to light. In light of Mr. Carnes' comments and this appendix in your comments that there may be more weaknesses, do you have an idea where those are coming from and what your findings are?

Mr. BERMAN. At this stage in our audit, we are deep into the planning phase where we are examining those systems, and we are examining the status of the 18 material weaknesses. The number itself may change in either direction and that amount could actually be reduced because some of the weaknesses that were identified might have been material to the individual components but not with DHS as a whole. It is also possible that new material weaknesses will come to light.

Part of our work is doing penetration tests of these systems to see whether they can withstand the kind of techniques that hackers and others might use. Material weaknesses on information security are common throughout the government.

Again, the number could go up or go down, and some may get consolidated. The important thing is that for weaknesses that are material to Homeland Security, whether 18 or less, that there is an effective plan for dealing with them.

Other weaknesses that may have been material before and might fall into a lower category called a reportable condition. Those also get attention and all of these issues are tracked by our office to see that all such weaknesses are fixed. So the number itself is not as meaningful as whether we capture all the weaknesses and there are action plans to fix them.

Ms. BLACKBURN. Speaking for myself, we grow a little weary at hearing after hearing as we hear, we just can't get our hands around this technology, that it is running us instead of us finding a system that works. I think that becomes a point of frustration. There is a recognition of the problem that there does not seem to be a desire—not really a desire, that is not fair. There is not really an action that is moving toward solutions.

Mr. BERMAN. I think there is a realization in government that some of the early efforts to develop what I would call mega systems—the $100 million class—from start to finish in-house, have been enormous failures. A lot of money went down the tubes and we have very little to show for it. There certainly seems to be an effort now and a recognition that probably the best way of getting new systems up and running is to basically use off the shelf systems that have proven their worth, have been tested and accepted by OMB, GAO and others, and adapt the procedures of the departments and agencies to those systems. They may not be perfect, and they may not answer all your questions and problems, but it is better to have 80 percent of the problem solved within a year with those kinds of systems than have no system after 5 years and $100 million down the tubes.

Ms. BLACKBURN. And I agree with you. When that enterprise architecture is there, it is a shame not to go in and pull what can be used from development of certain software applications or certain programs or certain languages and not apply that to what you are continuing to work for.

Mr. Berman, before I leave you, your OIG budget was increased by $12 million from fiscal year 2003 to 2004. Can the $11 million required for the fiscal year 2004 audit be accommodated within that increase or is there going to be an additional request?

Mr. BERMAN. The increase is somewhat misleading, Ms. Blackburn. Basically, we were funded for 7 months in fiscal year 2003. The increase for fiscal year 2004 was developed without our participation. The OMB basically assigned that number. We are not exactly sure what it was based on.

It certainly accommodates the staff and the expenses of the staff that we inherited. Unfortunately, neither the 2003 estimate nor the 2004 estimate included any money for the financial statement audits. For the first year, fiscal year 2003, with the efforts of our office and the CFO's office, we went back to the constituent agencies and basically asked them to contribute their fair share, particularly if they had funds allocated for that purpose for the whole year before the advent of Homeland Security.

We still came up short and both the CFO's office and our office kicked in a total of $6.8 million—$3.8 million from OIG—to assure the completion of this year's audit. No such arrangements have been made for 2004 and quite frankly the IG's cupboard is bare. We are no longer capable of contributing $3.8 million to the CFO audit without seriously impacting some of our other programs. For 2004 particularly, that could be a problem.

We don't really care whether funds are provided to us or to the department but certainly very soon we are going to need a confirmed revenue stream so that plans for the 2004 audit can begin. We effect the cost of the 2004 audit to be in the same ballpark, about $11 million. There will actually be savings in some areas but the $10.6 million that was spent this year excluded TSA who decided to go on their own with a full audit.

We will be doing all of the components next year but there will be some savings because we will no longer have to spend quite as much on opening balances.

Ms. BLACKBURN. Mr. Carnes, going back to you with the system, do you feel you have the financial resources and the human resources necessary to build the financial management system the way you envision it for the department?

Mr. CARNES. No, but I can get them.

Ms. BLACKBURN. Without additional costs?

Mr. CARNES. No.

Ms. BLACKBURN. And an estimated cost?

Mr. CARNES. That is wrapped in.

Ms. BLACKBURN. To the $150-$200 million?

Mr. CARNES. Yes. That includes the resources for contractor support to assist us in the development of requirements and then in the assessment of system options.

Ms. BLACKBURN. I have gotten confused somewhere. I thought you said you could do this by reallocating?

Mr. CARNES. Yes. I don't mean to mislead you here. I will reallocate those funds and use those to acquire contractual support as well as actual of the shelf system costs.

Ms. BLACKBURN. Just to be sure that I understand what you are saying, you can do what you need to do within the existing appropriations that you have?

Mr. CARNES. That is what I think now. I don't want to appear "dodgy" on this, but one of the things we are going to do first off is meet with all our component heads and make sure we know exactly what they need for information to manage their businesses. We have a sense of what those requirements are going to be and what those requirements will cost in order to satisfy but when we get further into this, we may find we have other requirements that we haven't yet anticipated.

I do have a funding plan for what we now envision as the scope of this.

Ms. BLACKBURN. Mr. Williams, as we talk about looking at the State and local agencies, not only with the grants but with the organization management and with the technologies, what is the best way for the department to go about remedying its lack of protocols or interface with State and local governments?

Mr. WILLIAMS. One of the areas that I also have responsibility for at GAO is the single audits. In looking at those, you have the Federal Government and then you have money going out to the various States, non-profit organizations, sometimes to the counties, etc. In an environment like that, you are faced with each of those entities can be unique and you have to work with each one of them.

I heard statements here today about putting in place procedures to make sure you are consistent in how you deal with all these agencies. That is a good step, to make sure that you have those procedures, that they are consistent, that what you are doing in the northeast part of the United States is the same thing you are doing in the southwest.

It is also going to require a tremendous amount of oversight and monitoring by the Federal Government because each of these entities can have some uniqueness and you will have to work with them to make sure they are carrying out the program or programs in the manner the Federal Government intends for that money to be spent.

Ms. BLACKBURN. Ms. Springer, as we look at the blending of the departments and at establishing good business practices, how much effort is going into to reducing duplication of systems and services and programs?

Ms. SPRINGER. I think as Mr. Carnes mentioned, there are 83 systems coming in; there will clearly be a much smaller number going forward. It is OMB's view in our Financial Systems Branch, as we looked at the legacy agencies and the systems that were coming into the combined entity, that there is a wide spectrum of capability in those systems and functionality. Clearly as it is harmonized, it is going to be much more efficient and redundancies would be eliminated.

We would feel this is really a good template in effect for what could be done throughout the government. If we can do it at this agency, that is a good model for what we can do with other agencies. For example, right now we have a project underway with the CFOs to look for future financial system upgrades to be able to do those as joint efforts because in the end all agencies will be doing

certain core financial functions together of the same type, paying bills, accounts receivable and payable.

There is a project underway right now but it would be modeled by, to some degree, what is happening right now at the Homeland Security Department. We believe there is a great potential for eliminating redundant and wasteful systems, picking the best of the bunch and making those apply across the board.

Ms. BLACKBURN. Thank you. I appreciate all of you and your time and interest.

Thank you, Mr. Chairman.

Mr. PLATTS. Thank you, Ms. Blackburn.

A bit on the previous questions of my colleagues. Mr. Carnes, you were appreciative of Dov Zakheim's work in Defense and his deputy, Larry Lanzolotta and the progress they are making and some of the clean opinions. We have had Mr. Lanzolotta here before us and gave us a good overview of the direction you are heading and a positive direction they are going and the positive results.

I believe one of the questions to him was his certainty in success. When he talked about we are going to eliminate this system that is not working and put it into this system that is going to work, his certainty that he could do that, and part of his answer was because of the position of Under Secretary Zakheim, being at the level, having that direct access and he deals with the other Under Secretaries for Intelligence, for Readiness, for Policy, he is on their level going right to the Secretary. He is Senate confirmed, he has that direct access.

When I translate that to DHS, we have taken the CFO and not followed that model that we agree is working at DOD and said we are not going to have that same level. I look at it from what is the message we send. Part of that is within the department, if we demote the CFO, in my words, from that Under Secretary level, and now responds and reports to an Under Secretary, within the department that says to the other Under Secretaries well the CFO comes to me and says you have a problem with one of your procedures or your internal controls, unless his boss actually says that is not equal. Within the department and outside the department, it sends a message we are less focused on financial management and accountability.

I look at some of the other Assistant Secretaries who have direct access. The Assistant Secretary for Legislative Affairs has direct access to the Secretary. The Assistant Secretary for Public Affairs but the person day to day handling the money, the CFO doesn't have that.

What am I missing? To me there is this glaring inconsistency and DOD, in your words, is a good model and you are bringing people over from DOD to follow that model, why shouldn't we follow them in hierarchy, the structure we have in place, not just today but 5 or 10 years from now, that it is guaranteed?

Mr. CARNES. First off, let me say I understand the thrust of your argument. Let me make this comment. What I see from my vantage point outside of DOD as a major difference is that the initiative that Dov Zakheim is working on and Larry Lanzillotta, is supported strongly, loudly and clearly from the top of the Department of Defense. They have put the bat in the dog's hands and he can

swing. It doesn't matter what his title is and it doesn't matter, I think, whether he is confirmed or not. It is whether he is perceived as having a bat in his hands. If he is perceived that way, in the past that was not always the case. It was always a question of the level of commitment on high because even Dov Zakheim can't order these other Under Secretaries around unless he has the bat in his hand and he has it.

Mr. PLATTS. One of the important words there was the perception. At DHS, the perception is we are lessening the role of CFO and add to that perception the fact that Mr. Berman said, we have no money in the 2003 appropriation, you had to go with hat in hand to collect enough money to do the financial statement audit.

Given the reorganization, I think that is more understandable but the 2004, no allocation for the financial statement audit in 2004 is not easily explained. That reinforces the message that we are talking about these issues but our actions demoting the CFO, my term, we are not appropriating money for the audit, don't know where it is going to come from, and given the Sunday article in the Times which says every agency in DHS is strapped for cash to fulfill its mission, it reinforces that perception that this is not a priority.

I realize you have an agency and office to represent and you represent that position but it seems hard to defend that we are sending the right message by our actions or by perception of those actions.

Mr. CARNES. I am starting to feel real bad about myself.

Mr. PLATTS. I am not. I think very highly of the job you are doing. It may not sound like it.

Mr. CARNES. When I went from Energy to Homeland Security, I went from a PAS position to a PA position. In the cosmology of appointee positions, that is a step down, a demotion. I took a demotion in those terms. I am a Presidential appointee and I am doing a mission that is important to the country and to the Secretary and to the President. I think I have the juice to get done what I need to get done.

Mr. PLATTS. I will personally tell you that I am grateful and I am not seeking to personally criticize your work but my worry is not today with the leadership you bring and the willingness to take that professional demotion to do such critical work, but what is it going to be in 5 years or 10 years? That gets to the crux of the issue and what message we are sending and what message is Congress going to stand behind.

Let me move on to some related issues. Ms. Springer, on the process, today under law is the CFO at DHS a member of the CFO Council, required by law?

Ms. SPRINGER. I don't know what the requirement of the law is to be perfectly honest with you but the CFO of the Homeland Security Department is an active, full participant in the CFO Council.

Mr. PLATTS. My understanding is by law he is not required to be but is that your understanding, Mr. Carnes?

Mr. CARNES. Yes.

Mr. PLATTS. The administration has chosen to include him. I asked that because when we have had CFO after CFO, we have talked to some informally and some in our hearings, the CFO

Council has been heralded as a great resource for all our CFOs because you can learn from each other what is working and what isn't working, learning from DOD to apply those and it seems it would be logical that we by law say this department's CFO has a place at the table, with DOD, Transportation, everybody else, and by law we want to make sure that the administration 8 years from now, 10 years from now doesn't say that is too cumbersome and is not required by law. It seems logical to require that to ensure that this department has that same advantage.

Ms. SPRINGER. Let me give you a little perspective. If I back up and look at the CFO Act, I don't think the administration would represent that it doesn't want the Homeland Security Department to not be subject to the act. It does and in every way, shape or form with two exceptions. We are acting that way today, the two exceptions being the organizational structure—the reporting structure—and the confirmation issue.

I guess what I would like to think is that maybe there is a way we could find to work this out with respect to not letting those two issues be such a stumbling block, that we can ensure for the future, that in all the other substantive ways that the act would be applicable and have the full force of law for this department or any other Cabinet agency.

Certainly from the standpoint of the confirmation, should the proposal be accepted that would eliminate confirmation across the board, that issue may be in the process of being addressed. I can't say for sure. That would leave the issue of the reporting structure. I would certainly hope that we could work with you and the Senate to find a way to deal with that.

Mr. PLATTS. The 80-some positions that are being floated out there not to be Senate confirmed.

Ms. SPRINGER. I have no knowledge of that.

Mr. PLATTS. My understanding is of those, none have similar fiduciary responsibilities that the CFOs do under Federal law in the sense of the finance and fiduciary responsibility, so there are differences in the types of positions, especially as Congress has perceived the CFO as a top position and senior position with direct responsibility and direct access.

Ms. SPRINGER. Again, I am sure you are right. I haven't seen it and haven't been part of it.

Mr. PLATTS. In your position as Controller, you deal extensively with all our agency and department CFOs?

Ms. SPRINGER. Yes.

Mr. PLATTS. Ballpark, what percentage of your job relates to that work, working with and overseeing the numerous CFOs?

Ms. SPRINGER. I would say at least three-quarters of it.

Mr. PLATTS. Would it be the administration's position that if we don't need to have Senate confirmation for CFOs, that three-quarters of your work is to relate and work with them, that your position which is now statutorily required to be Senate confirmed, Presidential appointment, not be Senate confirmed as well?

Ms. SPRINGER. I think it may be that you could apply by extension that same type of logic. I am not sure. I haven't thought about it. I would tell you that in the 7 months while I was awaiting confirmation, I feel I could have done the same job if someone had said

to me, we will exempt you from the confirmation, just go ahead and start.

Mr. PLATTS. I think that the challenge here for you individually and Mr. Carnes for you is in looking at the institutional integrity, meaning long term, and structural integrity. In the example I referenced earlier, in my understanding at DHS the Deputy CIO is the person in question who is now suspended with paid leave where the administration made a senior appointment that apparently involved an individual whose doctoral degree was not a doctoral degree as we would normally envision, not from a Department of Education approved institution, not years in the works but a few hours and several thousand dollars in the works. So, it brought into question the accuracy.

That is what the Senate confirmation, as flawed as it is from an internal sense, seeks to do, ensure accountability of these people who are placed in these senior fiduciary positions. There is a very extensive process as to their qualifications and background. That Deputy CIO isn't a Senate confirmed person, didn't have to go through that, and is an example where some apparent alleged inaccuracies in their qualifications have now come to light. That is what we are trying to avoid, not for you personally but for that institutional integrity of OMB and these departments because there is no way today's administration can guarantee what an administration in 10 years is going to do.

Mr. Williams, I wanted to ask you to give me your opinion on that statutory requirement that the CFO at DHS be a part of the CFO Council and have that same level of responsibility and authority as the other departments.

Mr. WILLIAMS. As I stated in my testimony we strongly support that the CFO at the agency, not just at the Department of Homeland Security but throughout the Federal Government, the major CFO agencies, that this individual should be one that has the qualifications, should be one placed in a position in the organization that is at the table when decisions are made and should be an individual that should be scrutinized to make sure you have an individual that is qualified to serve in this particular position.

I think when we drafted the legislation we included areas such as budget, accounting, and financial management systems. So we were hitting on all those major components that we had observed and in some cases, we brought in individuals from the private sector, from the State governments, and from the Federal Government to get their perspectives on exactly what should this individual's background and experience be and how should we go about making sure this is an individual who is respected when it comes to the management team, an individual that can bring some experience to the table, who has worked in this area, knows how to go about overseeing the development of system, knows how to put internal controls in place to make sure Federal funds are safeguarded.

Mr. PLATTS. I want to recognize Mr. Towns.

Mr. TOWNS. I don't have a question but I would like to associate myself with the remarks made by Chairman Todd Russell Platts of Pennsylvania. I would like to associate my remarks in terms of confirmation. I really feel very strongly about that. We can't talk

about it enough. You said almost everything that can be said on it but I would like to associate myself with those remarks.

Mr. PLATTS. Thank you, Mr. Towns.

I want to switch to the internal control audit issue. We have had some discussion of that. I understand your reference to Sarbanes-Oxley in your testimony and the fact that we are now going to be requiring this type of auditing of internal controls in the private sector, and the fact those regulations have been delayed to allow it to be done in a responsible and orderly fashion. I think that is different than not doing it at all. Mr. Berman I think your statement acknowledged there has been a delay. Recognizing and translating that to the Department, the need for management to be able to make its assertions about its internal controls, perhaps that means having at least 1 full year, 2004, to go forward and make its assertions that are then in 2005 subject to an internal control audit.

What is your position as far as having that requirement that it just be done in a more responsible fashion timewise versus not having it at all?

Mr. BERMAN. Our office is clearly in support of the requirement. We believe there are substantial benefits, both from the rigor that it adds to the process that the department has to go through to make that assertion and to the depth of the audit procedures required to test that procedure.

Mr. PLATTS. You raised concerns about the cost.

Mr. BERMAN. The cost and the timing. Again, the requirement in the bill was for 2004 and part of the problem is related to the process that is required both by the department and the auditors. The standards for auditors and management to follow in testing and assertion on internal controls are changing. Based on our understanding of the discussion going on in industry, there is disagreement as to the actual procedures required and certainly what we heard both from studies that have been done in response to requests for estimates of the cost increases, and even statements by the SEC, people who have examined the process based on their own experience have come up with estimates of 25, 50, even 100 percent increases in the audit costs.

Mr. PLATTS. If I can stop you there for a minute, I understand from a time sense that it is done in a responsible time fashion, 2005 versus 2004, and given that you don't even have money for your financial statement audit for 2004, I understand your concern. We have already moved over $3.4 million to the IG for the 2003 audit. I understand the concern financially.

The estimates you received especially from KPMG and their work doing financial audit, and they have given you an estimate for what they think an internal control audit would cost.

Mr. BERMAN. Yes, but it partly depends on the way the standards that have been proposed by the American Institute of CPAs plays out, and partly on the depth that the department reaches in testing its own controls. The assertion part of the process is more rigorous. Not only does management have to basically make assertions that its controls are adequate to the best of its ability, but that they have actually tested the effectiveness of those controls.

The depth that the department is able to go would affect the amount of procedures required in the audit. So there are tradeoffs here. It is impossible at this point to come up with specific estimates as to what it would cost us. We have other things going on in 2004 to meet the accelerated reporting dates. This would be an additional burden on the CFO's office, but if, based on your formulation, the CFO's office and management were able to come up with such an assertion—that they accept responsibility for controls and, based on their own tests, these controls are operating properly—hopefully by 2005, whatever dialog is going on regarding the actual procedures to be used in the audit and which any CPA doing the audit would have to follow, is concluded, we would be able to do that in 2005 with funding.

Mr. PLATTS. And the depth of the investigation is certainly going to be driven somewhat by funding as well.

Mr. BERMAN. Funding and personnel resources. I can certainly vouch for the fact that Mr. Carnes' office is lean.

Mr. PLATTS. As you looked at those estimates and whether it is a private accounting firm or SEC, I want to get the opinion, GAO is doing this type of audit on itself and on three or four other Federal agencies that are doing this type of audits as well. Mr. Williams, I wanted you to touch base. GAO's experience is that there is not that huge of an additional cost if management's review is as extensive as it should be. The additional cost to get this audit is not maybe as extensive as the private sector or SEC, which is now for the first time looking at doing it, believes it will be. Can you expand on that?

Mr. WILLIAMS. There are a couple of things that I would like to add to the discussion. We at GAO have been issuing an opinion on internal controls at the FDIC, at IRS, and the Bureau of Public Debt, as well as other smaller agencies we are required to audit by mandate. In addition, there are three CFO Act agencies that currently receive an opinion on internal controls. I believe it is GSA, Nuclear Regulatory Commission and the Social Security Administration.

All audits we do at GAO are performed in accordance with a particular manual that we, along with the PCIE, have developed. Without getting technical on this process, we as auditors basically look at the various procedures of how processes flow throughout the organization and then we will document those procedures and identify where there are controls in the particular process. Then we will perform a certain amount of tests.

One option that auditors can take if they are not following our methodology is that the auditor can stay away from a lot of that documentation and just go directly to the records and start testing the various accounts. What you get in that scenario is a number. If you go directly to testing those accounts, you will get a number at the end of the year, that we call in our financial statement audits, a number that is good for 1 day.

What you want to do and what I think this whole process is designed to get at, is to identify those weaknesses in your controls so that you can have them out there, transparent, so people can begin to take steps to correct those internal control weaknesses and get systems, get policies, get procedures in place so that information

can be produced on a routine basis so we don't have this exercise you have to go through at the end of the year.

In the process of what is called for in the new standards, there is one factor I would like to add. Following our yellow book standard requirements, agencies are not issuing an opinion on internal control, but are issuing a report on controls and looking at certain controls in the process. The FAM/PCIE reviews would require the opinion. It would cost more in going from just issuing the report on internal controls to issuing an opinion on internal controls. In that process, in going to issuing the opinion on internal controls, you are also getting the management assertion. As that process was being discussed, there is an 1982 act, the Federal Managers Financial Integrity Act, which already requires managers to do an assessment of internal controls. It can be done in numerous ways. I have seen some agencies do a bottom up approach where you start with the lowest level employee and document, what are my processes, what are my procedures, it rolls up and that information is consolidated.

The agency head is required to report on whether the controls are working effectively, as well as for those that are not, to put together a plan as to how they will go about correcting those. I think that is a good foundation for any agency in which management is beginning to go through this process of preparing an assertion on its internal controls. In other words, there is no need of duplicating your effort. There is a statute out there already that requires you to do some of this foundation or fundamental work that is called for in the new standards.

Mr. PLATTS. So under existing law?

Mr. WILLIAMS. Under existing law, there is a foundation you can work from. You might have to do more. That is on management's side.

On the auditor's side, the auditor would have to do some additional testing if they go from the yellow book to issuing an opinion on internal controls but in that scenario you can vary the amount of testing you would have to do, so there can be some give and take in that process based on what you find in the internal controls that management has asserted to and as you do your testing on internal controls.

Given that process, I think there are some things that over the years we have found to be very beneficial and that in the first years on some of these audits in which we issued opinions on internal controls, I think the track record will show there were more control weaknesses, material internal control weaknesses that have been identified at these agencies and we found management took a lot of steps to correct these weaknesses so there are some benefits that we have been able to identify over the years as agencies began to look at these opinions on internal controls.

I think there are some benefits. When you start talking about your costs and benefits and issuing opinions on internal controls, I think it is relatively easy to identify a number as to how much more it will cost in order to get an opinion, and if not a specific number, to get a range as to what you might think it would be.

I think the intangible or the part that is most difficult to measure is how much money am I saving by plugging a weakness that

I never knew about because I didn't look at those particular areas, I wasn't aware these weaknesses were here because I haven't done the necessary work to look in these particular areas.

Mr. PLATTS. That difficulty and that benefit, not just a benefit for the current fiscal year but for every fiscal year thereafter.

Mr. WILLIAMS. That is correct.

Mr. PLATTS. That is a return over and over?

Mr. WILLIAMS. That is correct because under the new standards to the best of my ability, and I just read an article in the Journal of Accountancy, the most recent issue has an outstanding synopsis of what is required under the Sarbanes-Oxley Act and it goes into details of what work has to be done, what are some of the benefits and so forth.

One of the things that you will get is you should get a process in which auditors in the past would look at certain areas on a rotational basis, they might look at these particular types of transactions this year and for 3 years, they would look at other areas and then come back the third year but I think the new requirements would require auditors to look at these areas year after year so you would have to have assurance that these controls are still in place and operating the way they are supposed to.

Mr. PLATTS. I think the message in Sarbanes-Oxley from Congress is year in and year out is that investors have valid numbers to act on.

Mr. WILLIAMS. And have confidence in the numbers that are coming out.

Mr. PLATTS. The investor in the Federal Government and the taxpayer should have equal confidence in how we are spending their money versus earning a return for them.

Mr. Carnes, your statements were pretty frank and straightforward in your testimony and your written statements that you do not believe this legislation is necessary and specifically objecting to the audit on internal controls. Your quote is "Audits of internal controls should be reserved for special and unique situations where waste, fraud and abuse or misstatements were identified in the course of other audits or internal reviews, inspections or evaluations."

This is a followup to Mr. Turner earlier. Given this is the largest reorganization in 50 years, given that you know coming in other audits or internal reviews of these legacy agencies, what you are inheriting from other agencies, have 18 material weaknesses up front, and then look at the Inspector General's Office statement today and giving but one example of the lack of internal controls on one TSA subcontractor perhaps costing $6-$9 million more than it should have, if we are talking even 40 percent of $12 million, that is $4.8 million, ensuring this type of thing doesn't return every year, more than pays for itself.

I guess my question is your statement that you are looking at spending $150-$200 million in designing new financial management system, if these numbers are right, I think GAO would contend $4.8 million is probably a pretty high number, even if it is right, that cost benefit-wise it is a worthy investment. Your statement is clearly that no, it is not. Is that still your position today?

Mr. CARNES. I would make two quick comments. I was just reading a book about science. Remember the bathysphere, the little iron ball they would put two guys in and it would go down to the bottom of the ocean? The bathysphere was a great invention and it went down to the bottom of the Marinas Trench in the 1950's and has never gone again. It has never gone again because it would cost at least $100 million to do it again. So they would get some knowledge but folks thought that was awful expensive because I am not sure what I am going to find if I can find there are other ways to do this.

I guess that is what I am saying, and I will align myself with my colleague at OMB who says let us take a look. My position going in was certainly the things we are finding from audits now relate most of the time to internal controls and systems weaknesses. I take internal controls and system weaknesses very seriously. If we are going to go this additional step, then I think we ought to look at if we have some estimate of the cost benefit, the return on investment and how widely it ought to be applied.

Mr. PLATTS. It sounds like we are moving in the right direction from an absolute no in your written testimony to maybe more receptiveness to the proposal. I kind of qualified it with Mr. Berman that I do appreciate 2004 versus 2005. 2005 is probably a lot more realistic if we were to do it. You would have to have the money, and our intent is to have the authorization language in the bill as well because it is going to be an additional cost.

This goes to more the type of interactions between your department and GAO as we have emphasized with every department agency we have heard from, to work hand in hand with GAO especially in the area of audits of internal controls that has an extensive record. The Social Security Administration, $465 billion budget is auditing its internal controls, finding the money to do it.

Here it seems this would be a good precedent and yes, it is inconsistent with the other Cabinet level agencies and that may be something we want to look at as well because of the benefit to all agencies in doing it.

Your willingness to give more thought to it and the openminded approach to the cost benefit analysis, along with OMB, is encouraging to me.

I want to touch on one more issue but I know we are getting late and starting late didn't help. In the broad issue of financial management, we touched on it somewhat in our discussions, is the material weaknesses and especially the need to address those weaknesses day in and day out so that we don't get to the end of the year.

I would be interested Mr. Carnes and Mr. Berman from within the department and maybe this will be repetitive on the systems you are planning on putting in place, that when we are shooting for the 2003 financial statements and especially the 2004 and every year after, that INS isn't having to shutdown for 2 weeks to at the end of that year make that heroic effort and that is not the norm. The norm is that any day, as Mr. Williams says, you can take a snapshot and you know where we stand.

The work that comes through my district office is related to INS. I don't want them shut down for a single day because of the work we are giving to their mission with the general public.

What do you envision as we go forward to ensure those heroic efforts are the exception not the norm as we have seen be the case throughout Federal Government?

Mr. BERMAN. As Mr. Carnes pointed out, INS has developed new systems and those systems are basically still being tested as we speak. Some of the results look promising so far. We have developed an audit process this year that at least avoids the need to shut all of their centers down. They are probably going to be doing that on a selective basis simply to test the integrity of the system to see how close it comes. We are hoping the results of those tests will show the new systems are operating at least sufficiently so that we can basically rely on the numbers they are producing. I say amen to the hope that we have seen the last of those kinds of heroics.

Mr. CARNES. That situation is clearly unsatisfactory. It has to be fixed.

Mr. PLATTS. I would add that the announcement last week by the Secretary regarding the emergency preparedness grants is another systematic change that having everything under one roof will help to avoid the end of the year challenge of seeing who got what grant. That is an example we are looking for and appreciate the Secretary's initiative.

Mr. CARNES. One of the real hard parts on the ODP grants is that the Federal Government makes grants to States. States then make grants to the localities and that is where we fall down. We have an awful hard time reporting on which locality is getting how much money for which thing because it is being done by the States, not us. I am not complaining, I am just saying we don't have a reporting mechanism that is very sophisticated on that right now.

Mr. PLATTS. Ms. Springer or Mr. Williams, do you want to add anything?

Ms. SPRINGER. We have been working with the INS, with the Justice Department, the legacy agency, with Mr. Berman and the financial staff to keep in touch with the progress they are making. We are aware of the changes and we support what they are doing.

I will say I think by this shift and the INS coming under the scrutiny and the eyes of the OIG and the CFO here, I think that will be a very positive change.

Mr. WILLIAMS. I would just add each year when we produce our report on the consolidated financial statements of the U.S. Government, in the past few years the Comptroller General has testified as well as other officials at GAO that basically when you have to go through these heroic efforts, that is basically a hollow victory, and you have to spend all this time putting together these schedules and documents to come up with some numbers that really are good for 1 day out of the year.

I think that is another reason why we want to make sure we have procedures and policies and legislation in place to make sure internal controls are adequately documented, identified, material weaknesses reported so that you can get to the root cause of some

of these problems so you can have day-to-day information needed by managers for day-to-day decisionmaking.

Mr. PLATTS. We are going to wrap up. I want to make a few final comments.

First is how much I appreciate each of you and your efforts, whether OMB, GAO, and the Department. It is not rhetoric when I talk about public service. I have been doing what I want to do since I was 14 and one of the things I always wanted to be and strive to be is a public servant, not a politician, even though I have been active in the Republican Party for 27 years now. So I greatly admire you as public servants and the work you are doing.

While we have some healthy give and take here, it is about us sharing an end of the day mission of doing right by our fellow citizens and how to best do that and coming from different perspectives. As a lawmaker, after you are gone and after I am gone, I believe there will be a structure in place that the taxpayers are going to be well represented and accounted for and how the money is spent and accounted for. That is what a lot of our discussion today has been about.

I do appreciate your efforts, especially in the importance of the department's mission. I think the reasons behind this consolidation were so that we really are better coordinated and more efficient so that we are spending more money on protecting America as opposed to other wasteful expenditures like the contractor getting $69 million more than he should have. This financial accountability we are trying to ensure is structurally in place is about protecting America and not wasting their dollars.

I would conclude with a final statement and it is why I feel pretty passionate. Through the actual responsibilities and authority of the CFO, the Senate confirmations direct access and that perception of that position in the department and within the Federal Government in total is kind of summarized by the Acting Inspector General of the Department of Homeland Security in responding to us on the internal control audit and why maybe it is not necessary, although I disagree with him on that.

One of his statements in his letter to us at the end of July was "We believe the financial accountability for DHS should not be postponed," actually about not having the audit in 2003 versus 2004. His next sentence was "It is the department's newness, size and complexity that strongly argue for more oversight, not less."

What I see us currently doing is less oversight from Congress when it comes to the CFO Act and how it applies to the Department of Homeland Security and I think the Inspector General got it right. We need more oversight, not less.

We will continue to work with the Department, with OMB and GAO as we move forward and I greatly appreciate your patience in getting started today and your indulgence as we have gone into the evening. Thank you.

This concludes the hearing. The record will remain open for 2 weeks for submissions, some referenced by Mr. Towns for additional documentation.

This meeting stands adjourned.

[Whereupon, at 5:15 p.m., the subcommittee was adjourned, to reconvene at the call of the Chair.]

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